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# **Legal Phases of Farmer Cooperatives**

**FARMER COOPERATIVE SERVICE  
U. S. DEPARTMENT OF AGRICULTURE  
WASHINGTON, D. C.**

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**FARMER COOPERATIVE SERVICE  
UNITED STATES DEPARTMENT OF AGRICULTURE  
WASHINGTON, D. C.**





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# **Legal Phases of Farmer Cooperatives**

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**FARMER COOPERATIVE SERVICE  
UNITED STATES DEPARTMENT OF AGRICULTURE  
WASHINGTON, D. C.**

THE Farmer Cooperative Service conducts research studies and service activities of assistance to farmers in connection with cooperatives engaged in marketing farm products, purchasing farm supplies, and supplying business services. The work of the Service relates to problems of management, organization, policies, financing, merchandising, product quality, costs, efficiency, and membership.

The Service publishes the results of the studies; confers and advises with officials of farmer cooperatives; and works with educational agencies, cooperatives, and others in the dissemination of information relating to cooperative principles and practices.



## FOREWORD

THIS publication represents the third major revision of a bulletin prepared by L. S. Hulbert and originally issued in October 1922, as Department Bulletin No. 1106, of the United States Department of Agriculture.

The first extensive revision of the bulletin was issued in October 1929 and retained the number 1106. The next major revision was last issued as Farm Credit Administration Bulletin No. 50 in May 1942. Since Mr. Hulbert left the Department of Agriculture in December 1950, the current revision is entirely the work of Raymond J. Mischler, with the assistance of Farmer Cooperative Service.

The last 30 years have not only seen a tremendous expansion of cooperation among agricultural producers, but also a marked development in the statute law and judicial precedents establishing and clarifying the legal status of farmer cooperatives. Mr. Hulbert's bulletin has played a significant part in this development.

One of the functions assigned to the Farmer Cooperative Service under the Cooperative Marketing Act of 1926 (7 U. S. C. A. 451 *et seq.*) is "To conduct studies of the \* \* \* legal \* \* \* phases of cooperation, and publish the results thereof." Since May 1942, when the third revision of Mr. Hulbert's bulletin was released, many new developments have occurred and many additional cases have been decided affecting the legal aspects of farmer cooperatives. Accordingly, this revision has been made in furtherance of the responsibility of the Service under the law. The new matter for the most part has been woven into the text of Mr. Hulbert's bulletin, without disturbing its existing format or basic text which has had such wide favorable reception and use by those charged with the responsibility of advising farmer cooperatives on their legal problems.

Although this bulletin is published by Farmer Cooperative Service, it should be regarded as representing the conclusions, opinions, and findings of the author and reviser and not necessarily the official views of the Service or the Department of Agriculture.

JOSEPH G. KNAPP

Administrator

Farmer Cooperative Service

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## FOREWORD

This publication presents the first major revision of a book by L. A. Stearns and co-authors, which was published in 1962. The book has been revised to reflect the changes in the field of population biology since 1962. The new edition contains a new chapter on the evolution of life history traits, and a new chapter on the evolution of life history traits in plants. The book is intended for students and researchers in the field of population biology. The book is written in a clear and concise style, and is suitable for use as a textbook or as a reference work. The book is published by the University of Chicago Press.

LEON A. STEARNS

Author

First Edition 1962



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## Legal Phases of Farmer Cooperatives

AGRICULTURAL cooperation is a method of doing business. An agricultural cooperative is a business organization, usually incorporated, owned and controlled by member agricultural producers, which operates for the mutual benefit of its members or stockholders, as producers or patrons, on a cost basis after allowing for the expenses of operation and maintenance and any other authorized deductions for expansion and necessary reserves.<sup>1</sup>

The principle of doing business on a "cost basis" involves these concepts: (1) that the contract between a properly organized cooperative and its patrons vests the excess between its receipts and expenditures during an accounting period in its patrons, and (2) that, accordingly, a cooperative, as a legal entity, cannot have entrepreneur profit as respects any excess which is covered by such contract. This is in contrast to the status of this excess in the usual business corporation. There it is subject to the control of management as to its disposition *after* it has accrued, and hence is clearly a profit to the corporation. Accordingly, the present tendency in cooperative circles is not to use the term "profit" to describe this excess in a cooperative, but to use such terms as "net margins" or "net savings." Although a conscious effort has been made to recognize this trend in terminology in this revision, it was also necessary to accept the fact that many courts and writers have not recognized this distinction. Accordingly, the reader will find frequent use of the word "profit" in quoted material, or even in the text where that was considered necessary to present properly a court's holding in a particular case.

It should be kept in mind that a marketing or farm supply association of farmers is a capitalistic business organization for the financial advantage of its member-patrons. Few, if any, associations would be formed if it were not believed that they would operate to the financial advantage of their members. Associations are formed for the same reasons as other business enterprises. In a cooperative, however, the financial benefits accrue to the patrons, while in the usual commercial enterprise they accrue to those who have invested their money in the business.

It should not be assumed that it is unnecessary for a cooperative to have money, although the amount of money necessary for a given association depends upon the character of its business and the scope of its plans. Working capital and adequate financial resources are as essential for a cooperative as they are for any other commercial concern.<sup>2</sup>

In respect to a cooperative, producers may be shareholders or members, patrons, or investors. The patron relationship may create the legal relationships of creditor or debtor.

<sup>1</sup> Evans, Frank, and Stokdyk, E. A. *THE LAW OF AGRICULTURAL COOPERATIVE MARKETING*. 648 pp. Rochester, N. Y. 1937. See p. 3; Packel, Israel. *THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES*. 307 pp. Albany, N. Y. 1940. See p. 3.

<sup>2</sup> Evans and Stokdyk, *supra* n. 1, at 163.

Cooperatives in this country, formed for the marketing of farm products or for the purchase of farm supplies, or both, constitute one of the most important groups of farmer organizations. Their purpose is to engage in business activities incident to the marketing of the products of members or the acquisition of farm supplies for them. The foundation and framework of a farmer cooperative and all its methods and plans are for the purpose of aiding those producers who have united or who may unite in the enterprise to conduct it along sound, successful business lines. That agricultural producers have the right to market their own products through their own agencies is obvious.

The opposition which those concerned with the formation of agricultural cooperatives have encountered has been judicially recognized. In one case,<sup>3</sup> it was said:

The successful establishment of these associations has been attended with many obstacles. Those with whom such associations come in competition have been resourceful and active. They have appealed to the guilelessness and cupidity of the members, with a view of breeding dissatisfaction on their part with the association and inducing them to breach their contracts.

Forms of organization vary, but a few well-recognized principles distinguish the cooperative from the usual commercial organization.

The cooperative character of an association does not depend on whether it is formed with or without capital stock. Either type of association may be thoroughly cooperative if properly organized and operated. Likewise, the presence or absence of capital stock is not controlling on the question of whether a corporation is formed for profit of its owners as distinguished from the profit of its patrons. This depends upon how it functions.<sup>4</sup>

An association does not cease to be cooperative because interest is earned on its reserves, or because its money is prudently invested when not required for the normal operations of the cooperative. To hold otherwise would penalize thrift and good business management. In a case<sup>5</sup> involving a mutual insurance company, the court held that "A mere incidental profit earned by way of interest on its invested safety funds, or on its bank balances, does not change the purely mutual character of the company or indicate that its business, though thus earning a profit, is 'carried on for profit'."

The character of a corporation is determined by its functions and how they are performed. And a corporation may be entirely cooperative, although incorporated under a business corporation statute.<sup>6</sup>

Although neither the members nor the stockholders of a cooperative are ordinarily liable for its debts, they may enter into contracts to furnish the association with money or other property for its use.<sup>7</sup>

Substantial equality among the producer-members of a cooperative, with respect to its affairs, is fundamental. The one-man, one-vote principle is generally accepted by cooperatives, but it is not indispensable. Sometimes equality among members in the capital-stock form of association is furthered by limiting the number of shares which a producer may own. This is in contrast with the situation in the more common form of commercial corporation in which, from a legal standpoint, a shareholder may

<sup>3</sup> *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 212, 226 N. W. 378, 77 A. L. R. 391.

<sup>4</sup> *Celina & Mercer County Telephone Company v. Union-Center Mutual Telephone Association*, 102 Ohio St. 487, 133 N. E. 540, 21 A. L. R. 1145; *Read v. Tidewater Coal Exchange, Inc.*, 13 Del. Ch. 195, 116 A. 898.

<sup>5</sup> *Niles v. Central Manufacturers' Mutual Insurance Company*, 252 F. 564, 566.

<sup>6</sup> *Allen v. Llano Del Rio Co. of Nevada*, 166 La. 77, 116 So. 675.

<sup>7</sup> *Farmers' Cooperative Union of Lyons v. Reynolds*, 127 Kan. 16, 272 P. 108.



own any available number of shares. Frequently, even in capital-stock cooperatives, the shareholders are restricted to one vote each, regardless of the number of shares of stock owned. The dividend rate on the stock or membership capital of associations is restricted to what is considered a fair rate of interest. This again is in contrast with the situation in the usual commercial corporation, in which the dividend rate is, from a legal standpoint, unlimited. In one case, the payment of a fair rate of interest by a cooperative on its preferred stock was regarded as an operating expense, like interest paid on borrowed money.<sup>8</sup> The payment of a fair return on capital tends to produce equality among the shareholders or members because it eliminates the differences caused by the fact that some members utilize the association less than others or have contributed more capital than others to its establishment.

Usually, the question of whether an organization is a cooperative arises with respect to a particular statute or statutes. From a Federal standpoint, there is no all-inclusive statutory definition of an agricultural cooperative. For instance, an organization may meet the conditions of the Capper-Volstead Act<sup>9</sup> and not be eligible for treatment as an "exempt" organization under the Internal Revenue Code.<sup>10</sup>

Again, an association may be eligible for loans from a bank for cooperatives<sup>11</sup> and not meet the conditions of the Capper-Volstead Act. In some statutes, the words "cooperative association" are employed without being defined. In any such case those concerned must ascertain the conditions that must be met and the qualifications necessary for an organization to be regarded, from the standpoint of that statute, as a cooperative. Usually, under such a statute, all the basic requirements discussed herein must be met for an organization to be classified as a cooperative.

Sometimes the status of an association may not be determined simply by an examination of its organization papers. Despite the formal provisions of such papers, the actual control of an alleged agricultural cooperative may be possessed by persons who are not producers or members and the financial advantages may largely accrue to such persons. In other words, an organization may have the features of a cooperative but not the fundamentals; the form but not the substance. If an association formed as a nonprofit corporation engages in profit-making activities, it may be ousted through quo warranto proceedings from engaging in such activities.<sup>12</sup>

The persons with whom the general commercial corporation deals usually are not members; but in a farmer cooperative the members are usually also patrons; that is, they deliver their products to the association for marketing or acquire supplies from or through it. In a cooperative, the advantages to members accrue primarily because they are patrons of the association. Patronage of, and not money invested in, the enterprise determines the distribution of benefits. Accordingly, the progress that may be made by a

<sup>8</sup> *Garden Homes Co.*, 26 B. T. A. 441, reversed on other grounds, 64 F. 2d 593. Apparently the court regarded the capital, although in the form of preferred stock, as being in reality "borrowed" funds. Ordinarily, amounts invested in capital in that form would not be so regarded. See *Sabine Royalty Corporation*, 17 T. C. 1071, for a discussion of some of the tests as to whether a security is a form of stock or evidence of debt.

<sup>9</sup> See Capper-Volstead Act, p. 166.

<sup>10</sup> See Federal Income Taxes, p. 195.

<sup>11</sup> See Federal Statutes Mentioning Cooperatives, p. 247.

<sup>12</sup> *People ex rel. Hughes v. Universal Service Association*, 365 Ill. 542, 7 N. E. 2d 310. See also *Rockingham Cooperative Farm Bureau, Inc. v. City of Harrisonburg*, 171 Va. 339, 198 S. E. 908. Cf. *State ex rel. Arn v. Consumers Coop. Association*, 163 Kan. 324, 183 P. 2d 423.

cooperative and the results that may be achieved by it are directly and inevitably affected by the extent and the consistency of its members' patronage.

Membership in a cooperative confers certain legal rights, which are discussed more fully hereafter. At the same time, it imposes definite responsibilities. Ideally, members of an association should provide adequate financing, support the business through full patronage, elect competent directors, keep themselves informed on association affairs, and cooperate in carrying out their agreements and the commitments of the association. Experience has shown that an association with this type of support is more likely to succeed in accomplishing its objectives.

It is apparent that the relationship between the members and the association is much more intimate and personal than that between an ordinary corporation and its stockholders. The courts have recognized that this is true.<sup>13</sup> It has been said: <sup>14</sup>

Even though title may have passed, still the arrangement is for cooperative marketing. The status of the parties partakes of a trust or fiduciary character, and is not the simple relation of vendor and vendee; the fund derived from the marketing of the product being subject to distribution among the various producers, sales of whose product had gone to make it up.

\* \* \* \* \*

There was a fiduciary relationship here; defendant was dealing with plaintiff's property. It was its duty to get the best price possible for it, to make such deduction from the proceeds for expenses and other items mentioned in the contract as were required in necessity and reason, and to return to plaintiff his share of the profits remaining, if such there were, based upon the milk that he furnished. \* \* \*

Membership in a capital stock cooperative is had through the purchase of a share or shares of its stock and the meeting by the purchaser of any other authorized requirements of the association; membership in a non-stock cooperative is had through application for membership and acceptance by the association and the meeting of any other authorized requirements. A common requirement for both stock and nonstock associations is the signing of a marketing contract.

It should not be assumed that the members or stockholders of a cooperative, except in a technical legal sense, are separate and apart from the association. The members are the association, and the officers and directors of the association are simply their agents for the conduct of the joint enterprise. The officers and directors of an association are placed in office and continue there only through the action or acquiescence of the stockholders or members. In other words, the stockholders or members are the principal or the "employer" and the officers and directors are simply their "employees" or agents to direct the business; and agents are subject to the control of their employers.<sup>15</sup>

Frequently, if not generally, cooperatives on receiving the products of a member make an advance to him which constitutes a "part payment," or more accurately partial returns; final returns are made after the sale of the products or at the end of the pooling or marketing period.

<sup>13</sup> *California Canning Peach Growers v. Downey*, 76 Cal. App. 1, 243 P. 679.

<sup>14</sup> *Rhodes v. Little Falls Dairy Company, Inc.*, 230 App. Div. 571, 245 N. Y. S. 432, 434, 435, affirmed in 256 N. Y. 559, 177 N. E. 140. See also *Arkansas Cotton Growers' Cooperative Association v. Brown*, 168 Ark. 504, 270 S. W. 946; *Texas Farm Bureau Cotton Association v. Stovall*, 113 Tex. 273, 253 S. W. 1101, reversing 248 S. W. 1109 (Tex. Civ. App.); *Texas Certified Cottonseed Breeders' Association v. Aldridge*, 122 Tex. 464, 61 S. W. 2d 79, reversing 59 S. W. 2d 320 (Tex. Civ. App.); *Bogardus v. Santa Ana Walnut Growers' Association*, 41 Cal. App. 2d 939, 108 P. 2d 52.

<sup>15</sup> *Lexington Mill & Elevator Co. v. Browne*, 116 Neb. 753, 219 N. W. 12.

Pooling is a practice common to cooperatives.<sup>16</sup> It is an averaging proposition. For instance, the expenses incident to the operation of an association are pooled and are then divided among the members on an equitable basis. Many marketing associations pool the products received from their members; that is, they mingle those products which are of the same grade and quality so that the identity of any particular lot is lost. On the sale of the products in a particular pool, the association renders a final account to each member, based upon the quantity he contributed to the pool. Some associations pool returns without pooling products; that is, the returns from products of the same grade and quality which are sold during a given period, usually at varying prices, are combined and are then divided among the members on a unit basis.

Some associations, as cooperative livestock commission concerns, act simply as agents for members in the sale of their products; other associations take title to the products received from their members, but otherwise function and account to members as an agent. Nearly all marketing associations enter into contracts with members which require them for specified periods to deliver their products to the association for marketing. These contracts usually are comprehensive and state the undertakings of the association and the member with regard to the delivery and marketing of the products covered.

All States have statutes peculiarly adapted to the incorporation of marketing associations. Such associations, in many respects, function along lines similar to those followed by commercial corporations; that is, each of them has a board of directors, officers, and employees through whom the affairs of the association are conducted.

Informed and intelligent management is as necessary for success in a cooperative as in any other corporation. Management has been called the vital factor in the success of any cooperative. "Cooperative marketing of farm products appears to be a necessity. Its success, however, depends upon the business sagacity and honesty of those in charge."<sup>17</sup>

While this bulletin is primarily concerned with agricultural cooperatives, it should be observed that cooperation is not confined to agriculture. It exists in every field of business endeavor. The Associated Press "is a cooperative organization, incorporated under the membership corporations law of the State of New York, its members being individuals who are either proprietors or representatives of about 950 daily newspapers published in all parts of the United States."<sup>18</sup> Many of our largest life insurance companies are mutual organizations. Independent retail merchants frequently unite in associations for buying, advertising, and other purposes.<sup>19</sup>

Sometimes corporations attempt to masquerade as cooperative organizations; but the courts are quick to deny this status if, because of control or other facts, a corporation is not entitled to be so classified.<sup>20</sup>

<sup>16</sup> Christensen, C. L. POOLING AS PRACTICED BY COOPERATIVE MARKETING ASSOCIATIONS. U. S. Dept. Agr. Misc. Pub. 14, 12 pp. 1929; Bakken and Schaars, ECONOMICS OF COOPERATIVE MARKETING, 583 pp. N. Y., N. Y., 1937, pp. 431-472; see *Elliott v. Adeckes*, 240 Minn. 113, 59 N. W. 2d 894.

<sup>17</sup> *Dark Tobacco Growers' Cooperative Association v. Robertson*, 84 Ind. App. 51, 150 N. E. 106, 113.

<sup>18</sup> *International News Service v. The Associated Press*, 248 U. S. 215, 39 S. Ct. 68, 63 L. Ed. 211, 2 A. L. R. 293.

<sup>19</sup> Packer, Israel. THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES. 307 pp. Albany, N. Y. 1940. See p. 9.

<sup>20</sup> *Cunliffe v. Consumers' Association*, 280 Pa. 263, 124 A. 501, 32 A. L. R. 1348; *People ex rel. Hughes v. Universal Service Association*, 365 Ill. 542, 7 N. E. 2d 310;



It should not be assumed that a cooperative is not amenable to a statute simply because it is a cooperative. Associations generally, if they come within the scope of a particular statute and are not specifically excluded, are subject thereto. In Oregon, a statute was enacted "to encourage and reward the production of the highest quality of cream and milk, thereby effecting the improvement of one of the State's principal industries." This statute was upheld<sup>21</sup> against the contention of a cooperative (which "paid" its members and patrons for their cream without regard to its grade) that it impaired the obligations of its contracts with its members and patrons because it required those subject thereto to "maintain to the producer a price differential between each grade of not less than one cent (1¢) per pound of butterfat content."

A Georgia statute which permitted mutual insurance companies to have salaried agents, but which forbade other insurance companies to act through salaried agents, was held to be unduly discriminatory and to violate the equal-protection clause of the fourteenth amendment.<sup>22</sup>

A provision in the Fair Trade Act of Wisconsin was held unconstitutional by the supreme court of that State because it exempted "any cooperative society or association not organized for profit." In this connection the court said:<sup>23</sup>

That exemption is not confined to merely transactions between such an association or society and its members. It is equally applicable to sales made by such associations or societies in competition with other retail dealers to the public at large, but as to which such exempted associations or societies would be permitted to sell at less than minimum resale prices stipulated under the Fair Trade Act. Thus there would be defeated its "primary aim to protect the property, namely, the good will \* \* \* of the producer."

Although cooperative marketing statutes, generally, authorize associations formed under them to include in their marketing contracts provisions for liquidated damages, and also authorize the associations to enforce such contracts by suits for injunctions and specific performance, only one instance has been found in which the violation of such a contract was made a crime. A statute was enacted in Kentucky which made it a crime for a farmer who had entered into a pooling contract covering his tobacco to dispose of the tobacco contrary to the contract. The statute was enacted in Kentucky in 1908, as an amendment to a statute enacted in 1906 which authorized farmers to pool their tobacco. In a case in which a farmer was indicted, the statute was held unconstitutional by the Supreme Court of

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*Chickasha Cotton Oil Co. v. Cotton County Gin Co.*, 40 F. 2d 846, 74 A. L. R. 1070; *Affiliated Service Corporation v. Public Utilities Commission of Ohio*, 127 Ohio St. 47, 186 N. E. 703, 103 A. L. R. 264; *Driscoll v. Washington County Fire Insurance Co.*, 110 F. 2d 485; *Western Canal Co. v. Railroad Com.*, 216 Cal. 639, 15 P. 2d 853. See also *Keystone Automobile Club Cas. Co. v. Commissioner*, 122 F. 2d 886.

<sup>21</sup> *State ex rel. Van Winkle v. Farmers Union Cooperative Creamery*, 160 Ore. 205, 85 P. 2d 471. See also *New York State Guernsey Breeders' Cooperative, Inc., v. Noyes*, 260 App. Div. 139, 21 N. Y. S. 2d 347; *Nebbia v. New York*, 291 U. S. 502, 54 S. Ct. 505, 78 L. Ed. 940, 89 A. L. R. 1469; *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, 59 S. Ct. 993, 83 L. Ed. 1446; *Noyes v. Erie and Wyoming Farmers Cooperative Corporation*, 281 N. Y. 187, 22 N. E. 2d 334; *Turner v. Maryland*, 107 U. S. 38, 2 S. Ct. 44, 27 L. Ed. 370; *New York State Guernsey Breeders' Cooperative, Inc. v. Noyes*, 284 N. Y. 197, 30 N. E. 2d 471; *West Central Producers Cooperative Association v. Commissioner of Agriculture*, 124 W. Va. 81, 20 S. E. 2d 797.

<sup>22</sup> *Hartford Steamboiler Inspection & Insurance Co. v. Harrison*, 301 U. S. 459, 57 S. Ct. 838, 81 L. Ed. 1223.

<sup>23</sup> *Weco Products Company v. Reed Drug Company*, 225 Wis. 474, 274 N. W. 426, 433.



the United States,<sup>24</sup> because the statute as construed by the Supreme Court of Kentucky "did not authorize the pool to enhance the cost of crops above their real value" and what constituted their real value was considered too uncertain to form a basis for criminal action.

Many benefits accrue to agriculture generally from cooperative marketing and farm supply associations. Numerous instances could be cited in which the margins taken on products marketed for farmers or the mark-up on supplies sold to them have been materially reduced through the influence of what might be called the pace-setting work of cooperatives. These are indirect benefits that accrue to all farmers whether they are members of cooperatives or not. In fact, some farmers apparently fail to realize what the situation would be if their cooperatives were not functioning.<sup>25</sup> For example, farm supply associations have every incentive to furnish their members with the best and highest-grade feeds and fertilizers. Likewise, in marketing, associations have every incentive to handle the products of their members efficiently, and to obtain as wide and complete a distribution of such products as is practicable.

Farmers have a direct and vital interest in keeping the bridge between the producer and the consumer as short as possible and in decreasing the tolls on the bridge to a minimum. Obviously all transportation, handling, and marketing costs are reflected in the price which the consumer pays. Broadly speaking, when a greater percentage of the consumer's dollar is spent for transportation, handling, and marketing costs, a smaller percentage of the consumer's dollar is available for the farmer.<sup>26</sup> Moreover, the consumption of agricultural commodities is discouraged as the price is increased. Ordinarily industry is able to pass on to consumers its manufacturing costs plus a profit, but farmers find it much more difficult to do so.

Because agricultural production is influenced to a large extent by the whims of nature, agriculture is not able to adjust production to demand with the same ease and certainty as industry.

By means of efficient cooperatives, however, farmers may reduce the costs incident to the production, assembling, handling and marketing of their products. Industry determines how its products will be marketed. Farmers are increasingly doing likewise. Most of the products of industry are manufactured and distributed by large corporations which represent a pooling of capital. On the other hand, it is neither practicable nor desirable for farmers to pool their farms in giant agricultural corporations; so the only way in which farmers may proceed to market their products on a basis that is at all comparable with industry is through the medium of cooperatives.

Every farmer, as a producer, is in a sense a manufacturer and is directly interested in the costs of the goods which he must buy for conducting his farming operations. The lower his production costs the greater are his chances for deriving a livelihood. Again, this is a problem comparable to the problem of industry which aims to buy its raw materials on the most favorable basis to increase its chances of making a profit. Thus it is only natural that farmers should act together in the purchase of farm supplies. No one has so unquestionable a right to market the products of farmers or

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<sup>24</sup> *Collins v. Kentucky*, 234 U. S. 634, 34 S. Ct. 924, 58 L. Ed. 1510. See also *Commonwealth v. Hodges*, 137 Ky. 233, 125 S. W. 689.

<sup>25</sup> Stitts, T. G. THE COOP. AND ITS SECOND GENERATION MEMBERS. F. C. A. Cir. A-19, 20 pp., illus. 1940.

<sup>26</sup> Arnold, T. W. THE BOTTLENECKS OF BUSINESS. 335 pp. illus. New York. 1940. See p. 18.

to furnish them with supplies needed for production purposes as the farmers themselves.

Statistics compiled annually by the Farmer Cooperative Service on farmer marketing, farm supply, and service cooperatives show the importance of these organizations to the present day farmers.<sup>27</sup>

Cooperatives vary widely in character and in the manner in which they function. The largest group consists of marketing associations which act either on a purchase-and-sale basis or on an agency basis, assembling and marketing agricultural commodities with little or no processing. In some instances an association simply acts as bargaining agent for the purpose of entering into contracts with buyers covering the sale of members' products.<sup>28</sup> Dairy farmers frequently form associations of this type.<sup>29</sup>

Some cooperatives, like the livestock associations in the terminal markets, act as "commission agents" for their members in the disposition of their livestock. Some associations operate auction markets at which the products of their members are sold. Other associations do a considerable amount of processing of the commodities which they receive from their members. Farm supply associations sometimes operate on what is known as a car-door-delivery basis, receiving orders from their members and delivering supplies from the car at local stations.<sup>30</sup> Some farm supply associations operate feed mills in which grain is ground and mixed into feeds adapted to the particular needs of the members. An increasing number of farm supply cooperatives manufacture fertilizer which they supply to their members. There are, of course, organizations of farmers that are engaged in neither marketing nor purchasing, but it is beyond the scope of this publication to enter upon a discussion of the specific legal problems incident to them. Among these associations are cooperative telephone,<sup>31</sup> irrigation,<sup>32</sup> cold-storage locker,<sup>33</sup> rural electric,<sup>34</sup> burial,<sup>35</sup> and many other kinds of associations.

One of the oldest and most successful groups of farmer cooperatives exists in the field of insurance. There are mutual fire insurance companies, organized and operated by farmers, that have been in existence for 100 years or more.<sup>36</sup> In many parts of the country, mutual fire insurance

<sup>27</sup> Statistics of Farmer Cooperatives, 1954-55, FCS General Report 31, 73 pp., illus. Farmer Coop. Serv., U. S. D. A. June 1957.

<sup>28</sup> *Mountain States Beet Growers' Marketing Association v. Monroe*, 84 Colo. 300, 269 P. 886.

<sup>29</sup> *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 147 Ore. 503, 30 P. 2d 344; *Stark County Milk Producers' Association v. Tabeling*, 129 Ohio St. 159, 194 N. E. 16, 98 A. L. R. 1393; *Connecticut Milk Producers' Association v. Brock-Hall Dairy Co., Inc.*, 122 Conn. 482, 191 A. 326; *United States v. Maryland & Virginia Milk Producers' Association, Inc.*, 179 F. 2d 426, 193 F. 2d 907.

<sup>30</sup> *Appeal of Beaver County Coop. Association*, 118 Pa. Super. 305, 180 A. 98.

<sup>31</sup> *Gilman v. Somerset Farmers' Coop. Telephone Co.*, 129 Me. 243, 151 A. 440; *Limestone Rural Telephone Co. v. Best*, 56 Okla. 85, 155 P. 901.

<sup>32</sup> Hutchins, Wells A. ORGANIZATION AND OPERATION OF COOPERATIVE IRRIGATION COMPANIES. Circ. C-102, 54 pp., illus. Farmer Coop. Serv., U. S. D. A., 1936.

<sup>33</sup> Mann, L. B. REFRIGERATED FOOD LOCKERS. F. C. A. Circ. C-107, 20 pp., illus. 1938.

<sup>34</sup> *Garkane Power Co., Inc. v. Public Service Com.*, 98 Utah 466, 100 P. 2d 571; *Inland Empire Rural Electrification, Inc. v. Dept. of Public Service of Washington*, 199 Wash. 527, 92 P. 2d 258; *Carolina Power & Light Co. v. Johnston County Electric Membership Corporation*, 211 N. C. 717, 192 S. E. 105; *State on Inf. v. Sho-Me Power Coop.*, 354 Mo. 892, 191 S. W. 2d 971.

<sup>35</sup> *State v. Winneshiek Coop. Burial Association*, 237 Iowa 556, 22 N. W. 2d 800; *White River Burial Association v. Thompson*, 81 F. Supp. 18.

<sup>36</sup> Valgren, V. N. PROBLEMS AND TRENDS IN FARMERS' MUTUAL FIRE INSURANCE. F. C. A. Bul. 23, 42 pp., illus. 1938. See p. 1.

associations of farmers write virtually 100 percent of the insurance on farm buildings.<sup>37</sup>

For those who may be interested in the historical aspects of agricultural cooperation, a list of a few references on the subject has been prepared.<sup>38</sup>

It would be inappropriate in a publication of this character to discuss all the numerous cases, even though many of them involve cooperatives, arising under Federal and State statutes providing for the regulation and stabilization of the milk industry, but in the note below the reader is referred to sources in which many of such cases may be found.<sup>39</sup> In some instances the statutes were found to violate constitutional standards, and they were held unconstitutional.<sup>40</sup>

Likewise, no attempt has been made to analyze the cases arising under the Federal and State agricultural adjustment statutes. The first Federal Agricultural Adjustment Act was in part held unconstitutional<sup>41</sup> but, as subsequently amended and reenacted in 1938, it has been held constitutional.<sup>42</sup> Digests of many cases arising under such Federal and State statutes will be found in the various volumes of the American Law Reports, Annotated.<sup>43</sup>

Finally it should be observed that in addition to the statutory provisions directly applicable to and the court decisions involving the special and peculiar character of cooperatives, all the general rules of business law are as applicable to cooperatives as to other business concerns.<sup>44</sup>

<sup>37</sup> Valgren, V. N. DEVELOPMENTS AND PROBLEMS IN FARMERS' MUTUAL FIRE INSURANCE. U. S. Dept. Agr. Circ. 54, 31 pp. 1928. See p. 28.

<sup>38</sup> Bemis, E. W. HISTORY OF COOPERATION IN THE UNITED STATES. 540 pp. Baltimore. 1888.

Buck, S. J. THE GRANGER MOVEMENT. A STUDY OF AGRICULTURAL ORGANIZATION AND ITS POLITICAL, ECONOMIC AND SOCIAL MANIFESTATIONS, 1780-1880. 384 pp., illus. Cambridge, Mass. 1913.

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Elsworth, R. H. THE STORY OF FARMERS' COOPERATIVES. FCS Educ. Circ. 1, 31 pp., illus. Farmer Coop. Serv., U. S. D. A., 1954.

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Nourse, Edwin G. FIFTY YEARS OF FARMERS' ELEVATORS IN IOWA. Iowa Agr. Expt. Sta. Bul. 211, 271 pp., illus. 1923.

<sup>39</sup> *Brannan v. Stark*, 342 U. S. 451, 72 S. Ct. 433, 96 L. Ed. 497; *Stark v. Wickard*, 321 U. S. 288, 64 S. Ct. 559, 88 L. Ed. 733; *Nebbia v. New York*, 291 U. S. 502, 54 S. Ct. 505, 78 L. Ed. 940, 89 A. L. R. 1469; *Highland Farms Dairy v. Agnew*, 300 U. S. 608, 57 S. Ct. 549, 81 L. Ed. 835; *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, 59 S. Ct. 993, 83 L. Ed. 1446; *Holcombe v. Georgia Milk Producers Confederation*, 188 Ga. 358, 3 S. E. 2d 705; *Jersey Maid Milk Products Company, Inc. v. Brock*, 13 Cal. 2d 620, 91 P. 2d 577; 101 A. L. R. 64, 110 A. L. R. 644, 119 A. L. R. 243; 22 Minn. L. Rev. 809. See also, N. Brooks, Marketing of Farm Products Under Some of the Federal Regulatory Statutes, 6 S. C. L. Q. 247 (1954).

<sup>40</sup> *Van Winkle v. Fred Meyer, Inc.*, 151 Ore. 455, 49 P. 2d 1140; *Maryland Co-operative Milk Producers v. Miller*, 170 Md. 81, 182 A. 432; *Ferretti v. Jackson*, 88 N. H. 296, 188 A. 474; *Griffiths v. Robinson*, 181 Wash. 438, 43 P. 2d 977.

<sup>41</sup> *United States v. Butler*, 297 U. S. 1, 56 S. Ct. 312, 80 L. Ed. 477, 102 A. L. R. 914.

<sup>42</sup> *Mulford v. Smith*, 307 U. S. 38, 59 S. Ct. 648, 83 L. Ed. 1092.

<sup>43</sup> 92 A. L. R. 1482, 98 A. L. R. 1145, 102 A. L. R. 937, 114 A. L. R. 136.

<sup>44</sup> *Farmers' Coop. Packing Company of La Crosse v. Boyd*, 175 Wis. 544, 185 N. W. 234 (alleged fraud in sale of packing plant); *Manatee County Growers' Association v. Florida Power & Light Company*, 113 Fla. 449, 152 So. 181 (assumption of



## Organizing a Farmer Cooperative

**ALTHOUGH** it is beyond the scope and character of this publication to consider in detail all the factors which should receive attention in the formation of a cooperative, in the discussion which follows an attempt is made to focus attention on the fundamental objectives.

There is no Federal statute for the incorporation of agricultural cooperative marketing and farm supply associations. However, there are special Federal statutes administered by the Farm Credit Administration for the incorporation of national farm loan associations,<sup>45</sup> banks for cooperatives,<sup>46</sup> and production credit associations,<sup>47</sup> which may be regarded as farmer cooperatives. In 1940, Congress enacted for the District of Columbia a statute authorizing the incorporation of consumer cooperatives.<sup>48</sup> There is a Federal statute under which credit unions may be incorporated,<sup>49</sup> and one under which savings and loan associations<sup>50</sup> may be formed.

All States have statutes adapted to the incorporation of agricultural associations. Incorporation of such an association must be done under an appropriate State statute.

When incorporating a cooperative, or any other corporation, it is necessary to ascertain and follow the requirements of the statute under which it is proposed to incorporate. Such statutes generally require that a certain number of individuals, usually three or more, must unite in articles of association. The term "articles of association" describes the paper or instrument which is filed for record in conformity with law, for the purpose of forming a corporation. Those whose names appear in the articles of association, or, as they are sometimes called, articles of incorporation, are known as the incorporators.

contract by cooperatives); *Higgins v. California Prune & Apricot Growers*, 16 F. 2d 190, certiorari dismissed, 273 U. S. 781, 47 S. Ct. 460, 71 L. Ed. 889 (breach of sales contract); *Kansas Wheat Growers' Association v. Farmers' Elevator Company of Luray*, 127 Kan. 27, 272 P. 181 (conversion); *Farmers National Grain Corporation v. Kirkendall*, 183 Okla. 17, 79 P. 2d 570 (conversion); *Associated Seed Growers, Inc. v. South Carolina Packing Corporation, Coop.*, 186 S. C. 118, 195 S. E. 107 (cooperative liable on trade acceptances); *Baker v. Farmers' Welfare Union*, 3 S. W. 2d 155 (Tex. Civ. App.) (suit against former employer for recovery of furniture, etc.); *Genco v. Union Berry & Truck Association*, 167 So. 890 (La. App.) (suit for salary—defense that no salary was to be paid unless profits made); *Gust v. Muskegon Cooperative Oil Company*, 226 Mich. 532, 198 N. W. 175, 33 A. L. R. 772 (suit for personal injuries resulting from gasoline); *Federal Reserve Bank of San Francisco v. Idaho Grimm Alfalfa Seed Growers' Association*, 8 F. 2d 922, certiorari denied, 270 U. S. 646, 46 S. Ct. 347, 70 L. Ed. 778 (recovery allowed because taking of deposit by insolvent bank was a fraud on depositor); *California Pear Growers' Association v. Herspring*, 60 Cal. App. 503, 213 P. 518 (sales—right of inspection); *California Packing Corporation v. Sun-Maid Raisin Growers of California*, 64 F. 2d 370 (trade-marks); *California Packing Corporation v. Sun-Maid Raisin Growers of California*, 81 F. 2d 674 (trade-marks); *James v. Lake Wales Citrus Growers Association*, 110 F. 2d 653 (who are necessary parties to an injunction suit involving Fair Labor Standards Act?); *Grandin Farmers' Cooperative Elevator Company v. Langer*, 5 F. Supp. 425 (Agricultural Products Embargo Statute of North Dakota); *Sun-Maid Raisin Growers of California v. American Grocer Company*, 40 F. 2d 116 (trade-marks); *California Fruit Growers Exchange v. Windsock Beverages*, 118 F. 2d 149 (trade-marks); *Pavilis v. Farmers Union Livestock Commission*, 68 S. D. 96, 298 N. W. 732 (check signed in blank).

<sup>45</sup> 12 U. S. C. A. 712 *et seq.*

<sup>46</sup> 12 U. S. C. A. 1134 *et seq.*

<sup>47</sup> 12 U. S. C. A. 1131 (d) *et seq.*

<sup>48</sup> 54 Stat. 480; District of Columbia Code (1951 Ed.), § 29–801 *et seq.*

<sup>49</sup> 12 U. S. C. A. 1751 *et seq.*

<sup>50</sup> 12 U. S. C. A. 1464, upheld in *First Federal Savings and Loan Association v. Loomis*, 97 F. 2d 831.



The statutes require that the objects and purposes for which the corporation or association is formed shall be clearly stated in the articles of association or incorporation; that the name by which the association or corporation is to be known shall be given; and that the amount of capital stock, if the association is to have capital stock, shall be stated. Some of the other usual statutory requirements are the length of time for which the association is to exist, its principal place of business, the number of directors, and the period for which the incorporating directors are to serve. The principal place of business specified in the articles of incorporation need not be the place where the major part of the business of an association is transacted.<sup>51</sup> It merely fixes the legal residence of the association. Every provision included in the articles of incorporation of an association must be authorized by the law under which the association is formed; and if an unauthorized provision is included it is void.<sup>52</sup>

Application to be incorporated or for a charter is commonly made to an officer of the State, usually the secretary of state. The articles of association or incorporation or the certificate of incorporation as it is called in some States, which constitute such application, is submitted to this officer and, if he finds that the statute under which the incorporators are seeking to incorporate has been complied with and that the purpose of the association is one provided for in the statute, he approves the application.

The statutory requirements for incorporation should be followed strictly, and care should be taken to see that the State officials concerned with the formation of corporations function properly. In an Iowa case,<sup>53</sup> it was held that a cooperative was not incorporated, although an attempt to incorporate had been made, because of defects in the filing, acceptance, and verification of the articles of incorporation by the secretary of state of Iowa; and hence a creditor of the association recovered from the stockholders as partners.

The amount of discretion which the secretary of state, or like officer, has with respect to the acceptance or rejection of an application for a charter is not the same in all States.<sup>54</sup> Upon the approval by the secretary of state of the application for a charter, the corporation, in most States, comes into existence. The procedure in the different States is not uniform, but this discussion may give a general idea of the steps involved. Some States require that the charter or the articles of association, or both, must be recorded in the county where the association is to have its principal place of business. In certain States, it is necessary to advertise for a given length of time that an application for a charter is being made. The exact moment when a corporation comes into existence varies in the different States and depends upon their statutes. It is believed that all States require the payment of certain fees as an incident to incorporation.

The actual work of organizing an association usually is carried on by an organization committee which may consist merely of a voluntary and informal group of farmers interested in forming an association, or may be composed of more formally chosen representatives of a larger group of interested farmers. From the start, the committee should have the advice of a competent attorney who, in addition to his legal qualifications, should have a clear understanding of the cardinal principles applicable to coop-

<sup>51</sup> *Dairymen's League Coop. Association, Inc., v. Brundo*, 227 N. Y. S. 203, 131 Misc. 548.

<sup>52</sup> *People v. California Protective Corporation*, 76 Cal. App. 354, 244 P. 1089.

<sup>53</sup> *Wilkin Grain Co. v. Monroe County Coop. Association*, 208 Iowa 921, 223 N. W. 899, 225 N. W. 868.

<sup>54</sup> *Lloyd v. Ramsy*, 192 Iowa 103, 183 N. W. 333.

erative organizations and their activities, and the economic and business problems confronting the proposed association, so that he may be of maximum service to the committee.

Many of the cooperative marketing acts <sup>55</sup> urge those contemplating the formation of an association to communicate with the college of agriculture of the State or some other State agency concerned with agriculture for advice as to what "a survey of the marketing conditions affecting the commodities proposed to be handled may indicate regarding probable success." Advice concerning such matters may be obtained also from the Farmer Cooperative Service, United States Department of Agriculture, Washington 25, D. C.

The organization committee should have ever in mind the things to be accomplished. If the members are to realize the maximum benefits from their association, the association must have (1) sufficient volume of business; (2) ample capital to conduct the business; (3) a flexible capital structure which will automatically provide additional capital for growth and expansion; (4) a sound plan of operations; (5) a representative board of directors; (6) able management.

First and foremost, it should be clearly established that there is a real, economic need for an association of the character proposed before reaching a decision to organize. This fact cannot be over-emphasized, since cooperative marketing and farm supply associations are necessarily middlemen whose expenses must be borne by the members. It should never be assumed that a cooperative is needed or that it would be successful if formed. Careful surveys and investigations should be made to determine if the facts justify organizing an association.<sup>56</sup>

Before forming an association, it should be ascertained that it will have a sufficient volume of business to enable it to operate efficiently and economically. Associations to operate creameries have been organized in sections where the amount of milk that was available was insufficient to permit of an economic operation. Under such circumstances, an association is doomed to fail. Perhaps the lack of sufficient volume accounts for more cooperative failures than any other single cause.

Associations have been formed and have begun operations under conditions which could not permit them to function in the black, but with the hope that, as time passed the volume would increase so that they might operate successfully. However, prospective members frequently are unwilling to join an association which is operating in the red, since they feel that they will be called upon to make up losses previously sustained. New members may always be obtained more readily by a successful organization than by one which is unsuccessful.

In addition to sufficient volume a new association must be assured sufficient initial capital to handle the business. Generally, the determination of whether sufficient volume and capital may be obtained to justify the organization of an association is made by soliciting the subscription of farmers to an organization agreement.<sup>57</sup>

An organization agreement should be carefully prepared and carried out in strict accordance with its terms. In an Arkansas case the subscription agreement for stock provided that a corporation was to be formed to

<sup>55</sup> See sec. 5 of Bingham Cooperative Marketing Act of Kentucky, p. 301 of Appendix.

<sup>56</sup> ORGANIZING A FARMER COOPERATIVE. Cir. 18, 39 pp., Farmer Coop. Serv., U. S. D. A. Weaver, O. T., and Prickett, U. H. ORGANIZING A COOPERATIVE COTTON GIN. Cir. C-109, 66 pp., illus. See p. 24, Farmer Coop. Serv., U. S. D. A. 1939.

<sup>57</sup> See form, p. 309.

operate a cotton warehouse at a particular place but when the articles of incorporation were prepared they specified that the warehouse might be located at this place "or at such other place as the board of directors may select." This was held to be such a material departure from the original plan that it constituted a good defense to a suit on the subscription agreement of a subscriber for stock.<sup>58</sup>

Commonly, the organization of an association is made contingent upon securing subscriptions assuring the minimum requirements in volume and capital by a stated time. Thus, the expenses incidental to incorporating an association will not be incurred unless it is found that the farmers will furnish the volume of products and the initial capital required for an economic operation. Usually, provision is made in the organization agreement for a committee authorized to have active charge of the organization of the association; and this committee will supersede the interested parties who, up to this point, have served as an informal committee. As illustrating the care with which an organization agreement should be prepared it has been held that, if those interested in forming a corporation have agreed to pay money to a committee to be selected to organize a corporation, only the committee could sue therefor.<sup>59</sup>

The committee should function carefully within the limits of its powers if its members are to avoid personal liability. Unless it is specifically required that all the members of such a committee must act, action taken by a quorum is sufficient.<sup>60</sup>

The committee will be confronted with economic and business problems of a wide variety. Thus, it may have to decide whether to buy, build or rent suitable facilities, or to take over an existing enterprise; and it may have occasion to negotiate with prospective marketing or purchasing agencies. It will be called upon to develop a plan of operation, and this will involve determining the particular functions that the association will perform.

Cooperative marketing and purchasing constitute the two major activities in which cooperatives engage, and not infrequently an association will engage in both activities. In each activity, there are certain functions that may be performed. In the case of marketing farm products, the problem consists of taking such products from the farm to the consumer.<sup>61</sup> This means that the products may have to be assembled, graded, processed, packed, warehoused, shipped, and sold. Just how many of these services the association should attempt to perform is a question which should be answered only after careful study and analysis. Some marketing associations perform all these functions. Others only assemble agricultural products and consign them to market for further handling and distribution.

It sometimes happens that a cooperative which is performing an assembling function only cannot compete successfully with a concern that may be engaged in performing additional functions, such as warehousing

<sup>58</sup> *El Dorado Farmers' Union Warehouse Company v. Eubanks*, 94 Ark. 354, 126 S. W. 1075. See also *Divine v. Western Slope Fruit Growers' Association*, 27 Colo. App. 368, 149 P. 841.

<sup>59</sup> *Loutsenhizer v. Farmers' & Merchants' Milling Company*, 5 Colo. App. 479, 39 P. 66. See also *Canyon Creek Elevator & Milling Company v. Allison*, 53 Mont. 604, 165 P. 753.

<sup>60</sup> *Lennox v. Texas Farm Bureau Cotton Association*, 16 S. W. 2d 413 (Tex. Civ. App.).

<sup>61</sup> *Elsworth, R. H., and Gatlin, G. O.* Unpublished report "Analysis of Marketing Functions." U. S. Dept. Agr., Bureau of Markets and Crop Estimates, Division of Cooperative Relations, 19 pp., mimeographed, Washington, D. C. 1921.



of the commodities in question or in processing them, to a certain extent. Sometimes, an operator may be making virtually no money in the assembling of commodities, but at the same time he may be making good profits from one or more processing operations. It is therefore highly important for a group that plans on organizing or reorganizing a cooperative to determine how many marketing, distributing, or processing functions will be performed. Obviously, an association should not attempt to perform any function which may be more economically performed by others, unless the performance of the function in question is essential to the success of its operations as a whole. In the case of many associations that operate on a year-round basis, there is a growing tendency to diversify their operations if possible, so as to attempt to do sufficient business every month to meet current overhead and operating expenses. Thus, if the processing operations are carried on in only a few months of the year, it may be advisable to combine purchasing activities which continue throughout the year.

Insofar as a farm supply association is concerned, it may handle goods on a car-door delivery basis, or it may warehouse and retail farm supplies either with or without delivery service. In any event, it should endeavor to function in such a way as to make farm supplies available to its members at the lowest practicable net cost.

Since the volume of products and capital which an association will require for successful operations may depend, in large part, on the nature of services that it proposes to render, these services should be determined at least in part prior to the solicitation of subscriptions. Thus, a milk association which functions only as a bargaining agency will have less need for capital than an association which operates a wholesale processing plant.

We have heretofore mentioned the need for sufficient capital to finance the association. In soliciting the subscription of farmers for the formation of a cooperative, it should be thoroughly explained to them that they are going into business, and are simply setting out to perform for themselves certain functions previously performed by others. Naturally, it takes money to do this, and the capital furnished by farmers for a cooperative should be looked upon by them simply as an investment in their own business. Farm products have always paid their way to market; and the plants, packing houses, warehouses, and other facilities for processing and handling farm products have always been made possible by the profits from the handling of these products. If farmers desire to market their own products, they must furnish the capital that would otherwise be furnished in the usual commercial enterprise.

The initial financing of a cooperative should be done on as fair a basis as practicable. This means that theoretically, at least, a farmer who has twice as many products to market as his neighbor should furnish twice as much capital to the marketing association. This may be accomplished in the course of time by adopting a revolving-fund plan of financing, under which the patron contracts with the association that a flat rate per unit marketed, a percentage of the sales proceeds of all products marketed, or a percentage of all net operating margins to which he may be entitled as patronage refunds is to be invested in or loaned to the association for capital purposes.<sup>62</sup> This method of financing, which is believed to be the fairest, is discussed later under the head "Revolving-Fund Plan of Financing," at page 223. Under this plan, the current patrons of an association furnish capital for its financing in proportion to their patronage, and the capital

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<sup>62</sup> Sanders, S. D. "RETAINS" THAT NOBODY FEELS. 3 News for Farmer Cooperatives 5-6. Farmer Coop. Serv., U. S. D. A. 1936.

furnished by the patrons in former years is returned to the contributors in the chronological order in which it was furnished.

After the decision has been made to organize an association, it is necessary to determine the corporate structure of the association, and many questions, to a large extent of a legal nature, must be considered. Under the cooperative statutes in effect in the various States, either stock or nonstock associations may be organized, the one perhaps as easily as the other.

The attorney for a group that is desirous of forming an association should make a careful investigation to determine the statute under which the proposed association should be incorporated. Such a statute must authorize the formation thereunder of associations to carry on the activities in which the association is to engage. In Iowa it was contended in quo warranto proceedings that the term "manufacturing" in an incorporation statute did not include the generation of electricity, but the court held otherwise.<sup>63</sup>

It has been ruled that, if a statute provides only for the formation of agricultural associations, an association may not be incorporated thereunder to operate electric light and telephone systems for its members, or for the conduct of a grocery store.<sup>64</sup>

In a Kansas case<sup>65</sup> the question was presented whether a corporation "organized for the purpose of 'the encouragement of agriculture and horticulture'" can "engage in a general farming business for profit as its principal business" and the court said "No."

Sometimes it will be found that the taxes which an association may be required to pay will be less if it is incorporated in one State rather than in another.

Only those persons should act as incorporators who are eligible to do so. In general, under the statutes providing for the incorporation of agricultural associations, the incorporators must be residents of the State in which the association is being incorporated and producers of agricultural products. In general, an incorporator does little more than allow his name to be used in forming a corporation. In the case of a stock corporation, an incorporator need not be a subscriber for stock, unless this is a requirement of the statute.<sup>66</sup>

In preparing the articles of incorporation care should be exercised to have them include every type of business and activity in which the association may properly engage, not only because the expense of later amending the articles of incorporation is thus avoided but because it has been held that a cooperative may not later, as against a nonconsenting stockholder, fundamentally and radically amend its articles of incorporation so as to authorize it to engage in enterprises unrelated to those originally authorized in the articles of incorporation.<sup>67</sup> All statutory requirements must be fully met. In some jurisdictions statutes prescribe the amount of capital which must be subscribed and paid for in cash or its equivalent before a corporation may engage in business, without liability by the incorporators to creditors.<sup>68</sup>

<sup>63</sup> *State ex rel. Winterfield v. Hardin County Rural Electric Cooperative*, 226 Iowa 896, 285 N. W. 219.

<sup>64</sup> *Cooperative Agricultural Associations*, 29 Pa. Dist. Reports 321.

<sup>65</sup> *State ex rel. Boynton v. Wheat Farming Company*, 137 Kan. 697, 22 P. 2d 1093, 1098.

<sup>66</sup> *Bristol Bank & Trust Co. v. Jonesboro Banking & Trust Co.*, 101 Tenn. 545, 48 S. W. 228; *Kardo Co. v. Adams*, 231 F. 950.

<sup>67</sup> *Midland Cooperative Wholesale v. Range Cooperative Oil Association*, 200 Minn. 538, 274 N. W. 624, 111 A. L. R. 1521.

<sup>68</sup> *Zander (as receiver of the Four County Farmers' Mill Cooperative Association) v. Holm*, 159 Minn. 51, 197 N. W. 967; *Schoenburg v. Klapperich*, 239 Wis. 144, 300 N. W. 237.

In the case of cooperatives formed with capital stock, the terms and conditions in the organization papers with respect to dividends, if any, should be clear and explicit. Where a stock cooperative employed some of its stockholders for the collection of garbage, it was held that, inasmuch as all the stockholders had not agreed that they were to receive no dividends on their stock, an attempt to distribute all earnings of the corporation under the guise of wages, thus depriving stockholders who were not employed by the cooperative of any return on their investment, was illegal.<sup>69</sup>

It would seem that capital might be raised as easily for a nonstock association through the sale of revolving-fund certificates or, as they are sometimes called, certificates of interest or certificates of investment, as by the sale of stock in a stock association. From the standpoint of the Capper-Volstead Act, treatment as an "exempt" organization under the Internal Revenue Code or eligibility to borrow from a bank for cooperatives, no distinctions are drawn between the stock and nonstock types of associations. From the standpoint of controlling the character of the membership, it is believed that this generally may be more easily accomplished by a nonstock association.

Some associations are organized with both common and preferred stock. At common law, every stockholder, whether the holder of common or preferred stock, is a member of the corporation issuing the stock. The so-called standard cooperative marketing act specifically provides that the holders of the common stock are the members of the association. Usually, the common stock is the voting stock and may be held only by farmers, and the holders thereof are regarded as members. On the other hand, in some States, because of either constitutional or statutory provision, the holders of preferred stock are entitled to vote. In such States it may be found preferable to form a nonstock cooperative, so that the principle of "one-man, one vote" may be easily effected.

Many of the cooperative acts provide that no holder of common stock shall be entitled to more than one vote, regardless of the number of shares owned by him. Under statutes providing that each share of common stock carries a vote, it is necessary to stipulate that no person may own more than one share of stock if the principle "one-man one-vote" is to be retained.

Preferred stock is usually nonvoting, and generally such stock may be held by anyone. Consequently, preferred stock is sometimes sold for the purpose of obtaining capital from persons who are not eligible to own common stock. Preferred stock may or may not be preferred both as to dividends and in the liquidation of assets on dissolution.

Unless specific provisions are made to guard against it, the common stock of a particularly successful cooperative may acquire a book value much greater than its par value, and this has happened in many of the older associations. Under these circumstances, stockholders may be unwilling to have the cooperative sell additional shares at par to new applicants because they feel that this will reduce the book value of outstanding stock; and new applicants are reluctant to pay the actual value for the stock. These factors operate to restrict the sale of stock and prevent associations from obtaining new members. This situation may be met partially, at least in theory, by the declaration of dividends payable in stock or other certificates, or by the incorporation of a new association to take over the assets of the old association. If a new association is formed, stockholders in the old association usually receive, for their interest therein, stock in the new asso-

<sup>69</sup> *De Martini v. Scavenger's Protective Association*, 3 Cal. App. 2d 691, 40 P. 2d 317.



ciation. It is also possible to issue voting stock to those who expect to patronize the new association and to issue nonvoting preferred stock to others who do not.

The revolving-fund plan of financing may be used by a stock as well as by a nonstock cooperative, and this should operate to prevent the stock from acquiring a book value appreciably in excess of its par value. In the organization papers of a cooperative formed with capital stock, adequate provision should be made for revolving its stock, except that each producer who is to have the status of a member in the cooperative should continue to be the owner of at least one share of common stock. Moreover, it should be noted that a stock cooperative may use common stock, preferred stock, or revolving-fund certificates as the medium for revolving its capital.

The writer is of the opinion that the revolving-fund plan of financing may be adapted to any type of cooperative, even though there is no specific statutory authority therefor, since it would appear to be simply a matter of contract between the association and its members.

Generally speaking, it is considered desirable for a cooperative to meet the terms and conditions of the Capper-Volstead Act.<sup>70</sup> Likewise, if it is intended that an association have an "exempt" status under the Internal Revenue Code, care should be taken to meet the conditions for "exemption".<sup>71</sup>

In drafting the legal papers,<sup>72</sup> an attorney should constantly keep in mind that, in a cooperative, the financial benefits and advantages should accrue to the members because of their patronage of the association and not because of their investment. A cooperative should be simply an instrument by which the advantages of collective action on the part of member-patrons will redound to them on the basis of their patronage on as equitable a basis as is practicable. In this respect, cooperatives are unlike commercial corporations which endeavor to make money for their stockholders as investors.

Great care should be exercised to preserve the true cooperative character of the association by the adoption of suitable provisions in the articles and bylaws. Many associations have been organized, especially those formed on a stock basis, without proper restrictions with respect to voting rights and the right to acquire, own, and transfer voting stock. When such an association becomes successful, not infrequently one or more parties interested in conducting the organization on a commercial basis have acquired a sufficient number of shares to enable them to control the business for their own benefit. In other instances, stockholders who were no longer patronizing the association have sought to have it dissolved in order that the assets might be distributed among the stockholders.

The organization papers should contain provisions to insure that the producer-patrons will be the only ones who are entitled to vote and control the association. In the case of most nonstock cooperatives, this result can easily be achieved by providing that the only persons eligible for membership are those who are bona fide producers of agricultural products, and that a person whom the board of directors finds has ceased to be a producer-patron ceases to have the right to vote. In addition, the membership certificates should be made nontransferable, or at least should be transferable only with the approval of the board of directors, and then only to bona fide agricultural producers.

<sup>70</sup> See Capper-Volstead Act, p. 166.

<sup>71</sup> See Federal Income Taxes, p. 195.

<sup>72</sup> See forms beginning on p. 309.



If an association is to be incorporated with capital stock, provision should be included in the organization papers restricting the issuance of voting stock and its transfer to bona fide agricultural producers, and providing for the suspension of the voting rights of any member in case he ceases to be a producer or ceases to patronize the association. In addition, the association should have the right, at its option, to purchase the stock of any such member at its book or par value, whichever is less, as determined by the board of directors, or to require the transfer of such stock to any person eligible to hold it; and on the failure of the holder to deliver the certificate or certificates evidencing any such stock, the association should be authorized to cancel the stock on its books.

If the association exercises its right to purchase the stock or to cancel the stock in the manner stated, it becomes indebted to the former stockholder for the value of his stock. If the association issues nonvoting preferred stock, it is believed desirable to include a provision under which it may require a holder of common stock who has ceased to be eligible, to convert his common stock into shares of nonvoting preferred stock. As an alternative, a stockholder who ceases to be eligible may be required to convert his common stockholdings into revolving-fund certificates. The right to restrict the ownership and transfer of common stock and memberships in agricultural cooperatives is, in many instances, authorized by statutes and even in the absence of statute, this right has been sustained by the courts.<sup>73</sup>

Dividends, if any, on stock or membership capital should be limited to not to exceed 8 percent per annum. This is in accord with the requirements of practically all State statutes and with Federal statutes applicable to cooperatives. In practice, many cooperatives have seen fit to restrict dividends on invested capital to 4 or 6 percent and some associations have entirely eliminated returns on capital.

Voting on the basis of one-man one-vote is one of the most widely accepted cooperative principles, and the organization papers should ordinarily contain this provision, except, of course, in those States where each share of stock is entitled to a vote. It is also possible in some States to provide that the members shall vote on the basis of the volume of the patronage given to the association, or on the basis of the productive units owned by them, such as the number of cows, trees, or acres.

While voting by proxy is permitted in a number of the States, the practice of voting in this manner is not generally regarded with favor, since it tends to concentrate voting control in the hands of a small group. Consequently, the writer is of the opinion that proxy voting should either be prohibited or at any rate restricted so that one person may not cast more than a limited number of proxy votes, as, for example, five votes. Voting by mail has also been found practicable, and is authorized by law in many of the States. This method of voting appears to be particularly desirable in the case of associations operating over a wide area. In this way, an opportunity is given for a larger percentage of the members to participate than would normally attend a meeting.

In the case of a marketing association, marketing agreements clearly defining the rights and the obligations of the members and the association should be entered into, and usually the farmer-members should be obligated thereunder to deliver to the association for marketing all their products of the kind handled by the association. In addition to authorizing the association to make deductions for all costs, expenses and reserves, provision should also be made for capital accumulations from net margins

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<sup>73</sup> See Restrictions as to Transfer of Stock, p. 48.

belonging to patrons. It should be made clear that the association has unqualified title to such capital. Such capital accumulations should be evidenced annually by issuing either common stock, nonvoting preferred stock, revolving-fund certificates, or written advice which discloses to each patron the dollar amount of the allocation which has been reinvested in capital. Provision should be made, also, for the revolving of such capital in the chronological order in which it was acquired.

Provision should be made in the bylaws for showing the reserves (a form of capital to which the association should have the unqualified title) by years on the books of the association in such a way that the amount attributable to the patronage of each patron may be ascertained at any time. If the reserves are substantial in amount, individual book credits should be set up. The board of directors, in the event of a loss, should be authorized to reduce the reserves for the respective years on such basis as they deem equitable. Provision should also be made, especially if the association is to have substantial reserves, that those reserves be revolved by years. Unless capital reserves are "allocated" as required by the regulations of the Internal Revenue Service, they are subject to Federal income taxation.<sup>74</sup>

In the case of farm supply associations, students of cooperative purchasing generally agree that such associations should handle supplies at prices not less than the going market prices therefor, and should provide for the building up of reserves and capital out of net margins. Capital accumulations and reserves should be handled in the same manner as has just been suggested in the case of marketing associations and suitable provisions should be made in the bylaws of a farm supply association for accomplishing these purposes. For both marketing and farm supply cooperatives, provision should be made in the bylaws for the payment of patronage dividends either in cash or by the issuance of shares of stock or revolving-fund certificates, whenever this is appropriate to the method of operation which the association is to follow.

In most instances, it is believed desirable to have the compensation of directors, if any, determined by the members of the association, and to provide in the bylaws that directors shall be barred from holding the office of manager, and be restricted in the amount of special work they may do, for pay, for the association in any given year. Attention is called to the fact that it is sometimes desirable to include in the bylaws provisions setting forth the qualifications for the offices of directors and officers, and to provide further that in the event a director or officer ceases to be eligible for office, the board of directors may require that he cease to be a director or officer. In a number of the States, special statutory provisions provide a means for removing officers and directors.

It has been suggested<sup>75</sup> that in order to assure rotation in office, and thus obtain the benefit of new directors, it is desirable to provide in the bylaws that no person may be eligible for the office of director for more than two consecutive terms. There may be instances in which this may be deemed advisable. It has likewise been suggested that the bylaws should provide that there be at least two candidates nominated for each director to be elected. The purpose of this suggestion, of course, is to foster democratic control of the association.

In stock associations it is highly important that restrictions relative to the stock be printed on the certificates so as to give notice to all concerned of

<sup>74</sup> See Federal Income Taxes, p. 195.

<sup>75</sup> Ward, G. H. STRENGTHENING DEMOCRATIC CONTROL AND MEMBER PARTICIPATION. 12 Cooperative Journal 121-125. 1938.

the limitations to which the stock is subject. Where an association adopts restrictions for the purpose of confining its voting membership to producer-patrons, it is believed that such restrictions are binding on all new members and on old members who voted in favor of their adoption.<sup>76</sup>

The importance of having all matters pertaining to the organization of an association handled in strict conformity with the applicable legal requirements is illustrated by the numerous instances in which associations have been unable to enforce their stock or membership subscription agreements because of some legal defect in organization such as failure to file the articles of incorporation with the proper authority, failure to comply with the blue sky laws, failure to organize an association of the type and character described in the subscription agreement, or organizing an association before the conditions precedent to organization stated in the subscription agreement had been met.<sup>77</sup> Moreover, in a number of instances, actions have been brought by various States to forfeit the charters of associations which were defectively organized.

Since cooperatives are incorporated under State cooperative marketing acts, necessarily the charter and bylaws of an association and the methods of their adoption and filing should conform to the statute under which it is incorporated. Every statutory requirement should be strictly observed. In addition, it ordinarily is necessary to examine the general corporation laws of the State, since nearly every statute authorizing the incorporation of cooperatives provides that the general corporation law of the State, except where inconsistent with the cooperative statute, is also applicable to such associations.<sup>78</sup> Occasionally, some provision of the State constitution may also be applicable.

In the preparation of the marketing agreement, due consideration should be given to the court decisions as well as the statute law of the State. For example, if a liquidated-damage clause is used, it should be one which the State courts, under applicable decisions, will sustain as reasonable.

In approximately two-thirds of the States, an association must comply with the blue sky laws before engaging in the issue and sale of capital stock, memberships or other types of securities.<sup>79</sup>

The incorporators are the charter members of an association. By virtue of being the incorporators, they are, generally speaking, members.<sup>80</sup> Nearly all the cooperative statutes specify the percentage of members that is required for the adoption of bylaws. If the number of members is large, it is sometimes difficult to obtain the approval of the required percentage. Inasmuch as the first board of directors of an association under practically all of the statutes is named in the articles of incorporation, the board of directors may act for the purpose of doing anything that might be deemed necessary to make themselves, as well as the incorporators, members. In many instances, for convenience, bylaws are adopted by the incorporators and the persons who compose the board of directors, all of whom at the time are regarded as the only members of the association. Even though

<sup>76</sup> See *Reorganization of Association*, p. 62.

<sup>77</sup> See *Subscribers, Stock, Capital Stock*, p. 42.

<sup>78</sup> *Sagness v. Farmers' Cooperative Creamery Company*, 67 S. D. 379, 293 N. W. 365; *Schoenburg v. Klapperich*, 239 Wis. 144, 300 N. W. 237.

<sup>79</sup> See *Blue Sky Laws*, p. 26.

<sup>80</sup> *Low v. Connecticut & P. R. R. Co.*, 45 N. H. 370; *Lechmere Bank v. Boynton*, 11 Cush. (Mass.) 369; *Monterey & Salinas Valley R. Co. v. Hildreth*, 53 Cal. 123; 8 *Fletcher CYCLOPEDIA CORPORATIONS*, Perm. Ed., sec. 3756; *Ballantine's MANUAL OF CORPORATION LAW AND PRACTICE*, p. 886. See also: *Chase v. Lord*, 77 N. Y. 1, 6 Abb. N. C. 258; *Kardo Co. v. Adams*, 231 F. 950; *Beck v. Stimmel*, 39 Ohio App. 510, 177 N. E. 920.



bylaws for cooperatives are to be adopted in the manner outlined, it is generally regarded as highly desirable that as many of the prospective members as possible be acquainted with the terms and conditions of the bylaws and given such opportunities as are practicable to express themselves with respect to them.

In addition to performing the various legal services heretofore mentioned, the attorney who organizes a cooperative usually advises it regarding its State and Federal tax liability, applicable statutes with which it must comply, and reports which it must file; and procures licenses and permits for it if any are required.

After a cooperative is organized and operated, its success will depend upon a number of factors, but probably the most important of these is management. The selection of a manager is one of the most important functions that a board of directors performs. There is no magic in co-operation. Unless a cooperative can perform the functions that it is engaged in performing, at least as effectively as comparable commercial concerns, it will never achieve a large measure of success. The effectiveness with which an association functions is largely dependent on the manager. When the directors are considering the employment of a manager they should compare candidates with successful operators in the same field.

The location of the plant or plants of an association, the amount which an association has invested in permanent facilities, the relation between such facilities and the volume of business handled, are all factors affecting its success. Some associations have built facilities far beyond their needs and these excess facilities have proved a serious handicap.

The problems which cooperatives must face are essentially business problems and an energetic and harmonious board of directors, able management and sound business policies will go a long way toward assuring a successful enterprise.

## **Incorporated Associations or Corporations**

### **Nature and Characteristics**

A POINT to be made clear at the beginning is that an incorporated cooperative, whether formed with or without capital stock, is just as much a corporation as an incorporated organization formed to manufacture automobiles, farm implements, or steel. It is true that incorporated cooperatives are a particular type of corporation, just as incorporated commercial concerns or charitable organizations are particular types. As nearly all farmer cooperatives are incorporated, and as it is highly desirable, as a rule, that they should be, the greater part of this bulletin will be devoted to a consideration of incorporated associations. Whenever the word "association" is used herein, unless otherwise specified, an incorporated association is meant.

Some discussion of the characteristics of corporations may be desirable at this point. It should be kept in mind that these characteristics belong to incorporated cooperatives, stock and nonstock,<sup>81</sup> as well as other corporations. The term "incorporation" is used with reference to corporations which do not have capital stock as well as with reference to those which have capital stock. It describes the act of creating a corporation. A cor-

<sup>81</sup> *Meikle, receiver, North Pacific Fruit Distributors v. Wenatchee North Central Fruit Distributors*, 129 Wash. 619, 225 P. 819; *In re Mt. Sinai Hospital*, 250 N. Y. 103, 164 N. E. 871, 62 A. L. R. 564.



poration is an artificial entity created by the law; it is a creature of the law. The definition of a corporation which is probably more widely employed in this country than any other is that given by Chief Justice Marshall in the *Dartmouth College case*,<sup>82</sup> in which he defines a corporation as "an artificial being, invisible, intangible, and existing only in contemplation of the law."

"A corporation is an artificial being, separate and distinct from its agents, officers, and stockholders."<sup>83</sup> Just as Smith and Jones are different persons, so a corporation is normally a legal entity distinct from its agents, officers, stockholders, or members.<sup>84</sup> In a case arising under the Fair Labor Standards Act,<sup>85</sup> it was held that a cooperative association was not a farmer just because its members were.<sup>86</sup> Individuality, if the term may be employed, is the dominant distinguishing quality of a corporation. The stockholders or members of a corporation, as well as its officers and directors, may change constantly, but the existence of the corporation is not affected thereby. It lives on as unaffected by these changes as a man is unaffected by changes of clothing. As an engine is separate from the engineer who runs it, so a corporation is normally separate from its agents, officers, stockholders, or members.

The members do not have title to the property of a corporation.<sup>87</sup> They cannot transfer the legal title thereto, although all of them join in the execution of papers purporting to transfer the property.<sup>88</sup>

It can be done only through the proper officers or agents of the corporation. A corporation can act only through its officers or agents,<sup>89</sup> and these must have been authorized to act by the board of directors of the corporation. Normally, if one man acquires all the stock of a corporation, the title to the property of the corporation is not in him, and he can neither sue in his own name for damages to the property nor transfer title to it.<sup>90</sup> Neither can he if not an attorney, it has been held, represent the corporation in court.<sup>91</sup> A stockholder as such is not an agent of the corporation.<sup>92</sup>

A stockholder or member of a corporation has no control over any part of the assets of the corporation prior to its liquidation. A stockholder or member of an association, on the other hand, is not because of this relationship a creditor of the association; and the possession of a certificate of membership or of stock, whether common or preferred, is not evidence of indebtedness<sup>93</sup> but merely of ownership. It has been said that "the stock-

<sup>82</sup> *Dartmouth College v. Woodward*, 4 Wheat. 518, 4 L. Ed. 629, 635.

<sup>83</sup> *Lange v. Burke*, 69 Ark. 85, 61 S. W. 165; *Aiello v. Crampton*, 201 F. 891; *McCaskill Co. v. United States*, 216 U. S. 504, 30 S. Ct. 386, 54 L. Ed. 590; *McCarroll v. Ozarks Rural Electric Coop. Corp.*, 201 Ark. 329, 146 S. W. 2d 693.

<sup>84</sup> *Rutledge Cooperative Association, Inc. v. Baughman*, 153 Md. 297, 138 A. 29, 56 A. L. R. 1042.

<sup>85</sup> 29 U. S. C. A. 201 *et seq.*

<sup>86</sup> *Walling v. McCracken County Peach Growers Association*, 50 F. Supp. 900.

<sup>87</sup> *Rhode Island Hospital Trust Co. v. Doughton*, 270 U. S. 69, 46 S. Ct. 256, 70 L. Ed. 475, 43 A. L. R. 1374; *Wabash Ry. Co. v. Amer. Refrigerator Transit Co.*, 7 F. 2d 335; *Adams v. Farmers' Gin Company*, 114 S. W. 2d 583 (Tex. Civ. App.).

<sup>88</sup> *City of Winfield v. Wichita Natural Gas Co.*, 267 F. 47.

<sup>89</sup> *Grosfield v. First Nat. Bank*, 73 Mont. 219, 236 P. 250.

<sup>90</sup> *Button v. Hoffman*, 61 Wis. 20, 20 N. W. 667, 50 Am. Rep. 131; *City of Winfield v. Wichita Natural Gas Co.*, 267 F. 47.

<sup>91</sup> *Cary & Co. v. F. E. Satterlee & Co.*, 166 Minn. 507, 208 N. W. 408.

<sup>92</sup> *United States v. Strang*, 254 U. S. 491, 41 S. Ct. 165, 65 L. Ed. 368.

<sup>93</sup> *Sternbergh v. Brock*, 225 Pa. 279, 74 A. 166, 24 L. R. A. (N. S.) 1078; *Wineinger v. Farmers' & Stockmen's Loan & Investment Association*, 278 S. W. 932 (Tex. Civ. App.), affirmed in 287 S. W. 1091 (Tex. Com. App.).

holders are the beneficial owners of the assets of the corporation.”<sup>94</sup> Normally, if one corporation owns all the stock of another corporation, a subsidiary, the courts regard the two corporations as separate and distinct.<sup>95</sup> One organization is not responsible for damages caused by another where the latter, although chartered by the former, functions independently.<sup>96</sup> It has been held that a claim against one corporation cannot be used as a setoff in a suit brought by another corporation, although both have common officers, directors and agents and one is alleged to be a subsidiary of the other.<sup>97</sup>

However, if the subsidiary is not in all respects carried on as a separate, distinct, independent corporation, and if it appears that it is simply acting as agent for the parent corporation, the latter may be held liable on contracts entered into by the subsidiary with third persons.<sup>98</sup> In a Montana case,<sup>99</sup> the corporate entity of the subsidiary was said to be in “abeyance,” when all the stock was owned by one parent corporation, and the parent was taxed on the subsidiary’s property.

If the corporate form is being used as a cover or medium for effecting a fraud or working an injustice, the courts will disregard the separate entity of the corporation and will hold the persons interested therein liable or responsible.<sup>1</sup>

Under some circumstances the courts disregard the corporate fiction. In a proceeding instituted by the Federal Trade Commission, it was held that where retail dealers had formed a cooperative corporation all of whose stock was held by them, which corporation acted as their agent for purchasing purposes, this did not operate to cause the corporation to be a wholesaler.<sup>2</sup>

The courts are unwilling to allow one corporation to use another corporation for the purpose of evading its legal obligations. In an Oregon case<sup>3</sup> it was said:

The formation of the later corporation was a subterfuge resorted to by the older corporation only for the purpose of evading the agreement of said older corporation to purchase its entire requirement of said commodity from plaintiff, and that said later corporation is but a continuation of the former, under a slightly different name.

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<sup>94</sup> *Aransas Pass Harbor Co. v. Manning*, 94 Tex. 558, 63 S. W. 627. See also: *Pacific Fire Insurance Company v. John E. Morris Company*, 12 S. W. 2d 971 (Tex. Com. App.).

<sup>95</sup> *Cannon Manufacturing Co. v. Cudahy Packing Co.*, 267 U. S. 333, 45 S. Ct. 250, 69 L. Ed. 634; *People v. American Bell Telephone Co.*, 117 N. Y. 241, 22 N. E. 1057.

<sup>96</sup> *Farmers’ Educational and Cooperative Union of America v. Eakins*, 188 Okla. 324, 108 P. 2d 182.

<sup>97</sup> *Hollingsworth v. Georgia Fruit Growers, Inc.*, 55 Ga. App., 541, 190 S. E. 802, 185 Ga. 873, 196 S. E. 766.

<sup>98</sup> *Whitehurst v. FCX Fruit & Vegetable Service, Inc.*, 224 N. C. 628, 32 S. E. 2d 34.

<sup>99</sup> *Commercial Credit Co. v. O’Brien*, 115 Mont. 199, 146 P. 2d 637.

<sup>1</sup> *Mosher v. Salt River Valley Water Users’ Association*, 39 Ariz. 567, 8 P. 2d 1077; *McCaskill Co. v. United States*, 216 U. S. 504, 30 S. Ct. 386, 54 L. Ed. 590; *First National Bank of Chicago v. F. C. Trebein Co.*, 59 Ohio St. 316, 52 N. E. 834; *State Trust & Savings Bank v. Hermosa Land & Cattle Co.*, 30 N. M. 566, 240 P. 469; *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N. W. 1024, 60 L. R. A. 927. See also: *Continental Oil Company v. Jones*, 26 F. Supp. 694; *Hollywood Cleaning & Pressing Company v. Hollywood Laundry Service*, 217 Cal. 124, 17 P. 2d 709.

<sup>2</sup> *Mennen Company v. Federal Trade Commission*, 288 F. 774, 30 A. L. R. 1120, certiorari denied 262 U. S. 759, 43 S. Ct. 705, 67 L. Ed. 1219.

<sup>3</sup> *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 342, 147 Ore. 503, 30 P. 2d 344. See also *Manatee County Growers’ Association v. Florida Power and Light Company*, 113 Fla. 449, 152 So. 181; *Citizens Mutual Fire & Lightning Insurance Society v. Schoen*, 105 S. W. 2d 43 (Mo. App.).

The court, therefore, enjoined the successor corporation from violating the terms of a contract entered into by the predecessor corporation with a dairy cooperative obligating the predecessor corporation to obtain all the dairy products needed for meeting its requirements therefrom.

It has been held that a rural electric cooperative can acquire all the securities of an electric utility company and operate the company without violating the provisions of the New Hampshire law.<sup>4</sup> The court did not accept the argument that this permitted the cooperative to do indirectly certain things it could not do directly under the applicable statutes.

The stockholders or members of a corporation, whether stock or non-stock, are not generally liable for its debts. Ordinarily a majority of the stockholders of an association may not obligate nonconsenting stockholders to supply additional capital to an association.<sup>5</sup>

The fact that stockholders authorize the corporate officers to incur corporate indebtedness and execute corporate obligations does not render them liable for the contribution of proportionate amounts of liability incurred by the directors on behalf of the corporation.<sup>6</sup> In all jurisdictions, however, stockholders or members can be compelled to pay the amount which they have agreed to pay for stock of the corporation or for membership in it. Sometimes, as in New Jersey,<sup>7</sup> the law permits the organization of associations with limited liability by the stockholders or members for debts of the corporation. In Minnesota the constitution formerly imposed double liability on the stockholders of all corporations except those engaged solely in manufacturing.<sup>8</sup>

In every case the constitution and statutes of the State should be examined to determine the exact liability of stockholders or members in that State. The Supreme Court of the United States has held that an organization may be a corporation, although its stockholders are liable for its debts.<sup>9</sup> But, as a general rule, the stockholders of a corporation are not liable for its debts. From this fact results one of the great advantages of incorporation. It enables a man to venture a definite sum of money in a business without risk of losing more in case the business fails. Persons dealing with a corporation are charged with notice of its charter and the statutes of the State regulating its powers and duties.<sup>10</sup>

Every corporation suggests group effort on the part of those interested. Each of several of the large industrial corporations has more than 100,000 stockholders. The united effort in such organizations consists largely in the pooling of the money paid by stockholders for stock. If each of the original stockholders of one of these corporations had acted singly and independently in attempting to establish and increase the particular business involved, much less progress would probably have been made than was accomplished through the corporation.

<sup>4</sup> *Petition of White Mountain Power Co.*, 96 N. H. 144, 71 A. 2d 496.

<sup>5</sup> *Farmers' Coop. Union v. Alderman*, 126 Kan. 299, 267 P. 1110.

<sup>6</sup> *Fulton v. Farmers' Union Exchange*, 207 Iowa 371, 222 N. W. 889.

<sup>7</sup> 4 N. J. S. A. 13-25.

<sup>8</sup> *Lindeke v. Scott County Cooperative Company*, 126 Minn. 464, 148 N. W. 459; *In re Farmers' Dairy Company's Receivership*, 177 Minn. 211, 225 N. W. 22.

<sup>9</sup> *Liverpool Ins. Co. v. Massachusetts*, 10 Wall. 566, 77 U. S. 566, 19 L. Ed. 1029.

<sup>10</sup> *Sterling v. Trust Company of Norfolk*, 149 Va. 867, 141 S. E. 856; *Stuttgart Cooperative Buyers Association v. Louisiana Oil Refining Corporation*, 194 Ark. 779, 109 S. W. 2d 682.



## Antiquity of Corporations

The idea of a corporation is an old one. It is said to have been originated by the Romans, although there is not entire agreement among law writers on this point. Corporations were known to the Greeks and Romans centuries before the Christian era. Before the Norman conquest (1066) there existed in England organizations having many of the elements of corporations. Churches were among the first of these organizations. It was not until the middle of the seventeenth century that the large trading corporations of England came into existence. Chief among these was the Hudson's Bay Company, which is in active business today.

## Power To Create Corporations

The power of creating corporations resides in the sovereign. In England they were originally created by the King; later they were created by acts of Parliament with the express or implied assent of the King.<sup>11</sup> In this country the power to create corporations belongs to each State and the Federal Government. A State legislature may create a corporation or provide for its creation for any proper purpose and may confer upon it such powers as it sees fit, subject only to such restrictions as are found in the State and the Federal Constitutions.<sup>12</sup> Congress may create corporations whenever they are necessary or proper agencies for carrying into execution any of the powers conferred by the Constitution upon the Government of the United States.<sup>13</sup> Congress, because it has exclusive jurisdiction over the District of Columbia, has the same power to create corporations within the District that a State has to create corporations within its borders.<sup>14</sup>

Formerly all corporations in this country were created by special enactments; that is, a special act was passed by the legislature of the State every time a corporation was created. It was believed that this practice led to favoritism and unjust discrimination,<sup>15</sup> and practically all the States now have in their constitutions provisions prohibiting, with certain exceptions in some States, the creation of corporations by special acts.

Every State now has general statutes which authorize and provide for the formation of corporations. The statutes of some States are broad and permit the formation of corporations to engage in practically every form of lawful activity. Some statutes, however, permit only the incorporation of particular types of corporations or of corporations to engage in certain lines of business. Even though a business is lawful, if provision is not made for the formation of corporations to engage in that business, they cannot be incorporated in that State.

Those who wish to form a corporation must meet the terms and conditions prescribed by the State. The power of the State in this matter is supreme.<sup>16</sup> The legislature can grant just as little or just as much power to corporations, within constitutional limits, as it desires.<sup>17</sup> A cooperative

<sup>11</sup> Blackstone's COMMENTARIES, Book I, p. 472.

<sup>12</sup> *New Orleans Gas Co. v. Louisiana Light Co.*, 115 U. S. 650, 6 S. Ct. 252, 29 L. Ed. 516; *Northern Securities Co. v. United States*, 193 U. S. 197, 24 S. Ct. 436, 48 L. Ed. 679.

<sup>13</sup> *McCulloch v. The State of Maryland*, 4 Wheat. 316, 4 L. Ed. 314.

<sup>14</sup> *Georgetown v. Alexandria Canal Co.*, 12 Pet. 91, 9 L. Ed. 1012.

<sup>15</sup> *Wells, Fargo & Co. v. Northern Pac. Ry. Co.*, 23 F. 469.

<sup>16</sup> *City Properties Co. v. Jordan*, 163 Cal. 587, 126 P. 351.

<sup>17</sup> *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311; *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937.



was incorporated under a statute of Pennsylvania which, among other things, provided that all business of associations incorporated under it, except certain enumerated types, should be for cash, and that all persons who extended credit to such associations except for specified purposes should forfeit the amount of the credit thus extended. The statute required that notice to this effect be published on the letter and billheads, advertisements, and other publications of associations incorporated thereunder. Debts for purposes not contemplated by the statute were incurred by an association, and the creditors sought to throw the association into bankruptcy, but failed, as the court held that they had no claims which could be recognized in bankruptcy, owing to the provision in the statute referred to.<sup>18</sup>

In a California case, the validity of a statute providing for the forfeiture of the charters of all corporations which failed to pay a certain tax by a specified date was upheld.<sup>19</sup> A State can determine upon what conditions corporations formed in other States may do an intrastate business within its borders.<sup>20</sup> A corporation engaged in interstate commerce may enter any State for all the legitimate purposes of such commerce without the leave or license of the State.<sup>21</sup>

At one time the various States did not have statutes which were peculiarly adapted to the formation of associations, but during the last three decades many statutes have been passed by the State legislatures to provide for the formation of cooperatives.<sup>22</sup> Each State now has one or more such statutes.

The right of States to enact statutes providing for the formation by farmers of cooperatives and containing no authority for those engaged in other occupations to organize under them appears to be established. The Supreme Court of the United States has said: "Undoubtedly the State had power to authorize formation of corporations by farmers for the purpose of dealing in their own products."<sup>23</sup> Although corporations are now, as a rule, formed under general statutes, the act involved in bringing them into existence is regarded as a legislative one, and the rules relative to statutes are applied by the courts in construing charters.<sup>24</sup>

## Blue Sky Laws

A cooperative should ascertain if any plan which it intends to follow in obtaining capital is subject to the blue sky laws of a State in which sales or contracts will be made. "Blue Sky Law" is a popular name for an act providing for the regulation and supervision of investment securities sold to the public.

<sup>18</sup> *In re Wyoming Valley Coop. Association*, 198 F. 436. See also *Sterling v. Trust Co. of Norfolk*, 149 Va. 869, 141 S. E. 856.

<sup>19</sup> *Kaiser Land & Fruit Co. v. Curry*, 155 Cal. 638, 103 P. 341.

<sup>20</sup> *Burley Tobacco Growers' Cooperative Association v. Rogers*, 88 Ind. App. 469, 150 N. E. 384.

<sup>21</sup> *Dahnke-Walker Milling Co. v. Bondurant*, 257 U. S. 282, 42 S. Ct. 106, 66 L. Ed. 239; *Nebraska Wheat Growers' Association v. Norquest*, 113 Neb. 731, 204 N. W. 798; *Dark Tobacco Growers' Coop. Association v. Robertson*, 84 Ind. App. 51, 150 N. E. 106.

<sup>22</sup> Copies of the statutes of a particular State on this subject can be obtained usually by writing to the secretary of state of that State. Good examples of recent revisions are the short form statute enacted in New York in 1950 and the more detailed statute enacted in Wisconsin in 1955.

<sup>23</sup> *Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Association*, 276 U. S. 71, 48 S. Ct. 291, 72 L. Ed. 473, affirming 208 Ky. 643, 271 S. W. 695.

<sup>24</sup> *Casper v. Kalt-Zimmers Mfg. Co.*, 159 Wis. 517, 149 N. W. 754; *Lord v. Equitable Life Assurance Soc. of United States*, 194 N. Y. 212, 87 N. E. 443, 22 L. R. A. (N. S.) 420.

In a number of States the securities issued by marketing and farm supply associations are not subject to the requirements of the blue sky laws and in some States special statutory provisions exempt securities issued by rural electric cooperatives. It seems that, in the absence of a specific statutory exemption, the securities issued by cooperatives would be regarded as subject to the blue sky laws.

The blue sky laws generally are comprehensive in scope and cover, in addition to stock, various kinds of certificates or agreements which are issued or made to raise money.<sup>25</sup>

In Oregon it was held that the blue sky law of that State, by its terms, did not apply to certain transactions involving cooperatives.<sup>26</sup>

In Utah it was held that the blue sky law of that State was applicable to a corporation which claimed to be a cooperative and in which no one could acquire stock unless he agreed to raise sugar beets.<sup>27</sup>

Some of the blue sky laws apply to unincorporated as well as incorporated associations and some apply to nonstock corporations.<sup>28</sup> An association obtained a permit, under the Corporate Securities Act of California, to enable it to sell membership certificates for \$200 each. Because the association failed to exhibit and deliver to a producer the permit issued by the Commissioner of Corporations as required by its terms, it was held, at the suit of the member, that his membership and marketing agreement were void.<sup>29</sup>

Generally speaking, a note given for the purchase of a security of an organization that has not complied with the blue sky laws is at least voidable in the hands of any person who is not a bona fide holder.<sup>30</sup>

In Illinois, as the blue sky law of the State had not been complied with, a purchaser of stock in a cooperative recovered the sale price of the stock from the agent of the cooperative after it became insolvent.<sup>31</sup>

Where a corporation issued stock without complying with the blue sky law, which provided that contracts entered into for the sale of stock, if the law was not complied with, were void, it was held that inasmuch as the stockholder had accepted dividends and attended meetings of the corporation, he was estopped from asserting that he was not a stockholder.<sup>32</sup>

The action of the State Securities Commission of South Dakota was upheld in refusing to grant permission to a corporation to sell stock where "the contents of plaintiff's articles of incorporation are of a nature fitted to deceive the unwary, and to lead to the perpetration of a fraud upon

<sup>25</sup> *Hamlin County Livestock Sales Pavilion Company v. Karlstad*, 48 S. D. 82, 202 N. W. 141; *Farm Products Company of Michigan v. Jordan*, 229 Mich. 235; 201 N. W. 198; *Hill v. Campbell*, 90 Ind. App. 687, 169 N. E. 865; *State v. Gopher Tire & Rubber Company*, 146 Minn. 52, 177 N. W. 937; *State v. Hudson*, 214 Mo. App. 260, 259 S. W. 877. In *State ex rel. Arn v. Consumers Coop. Association*, 163 Kan. 324, 183 P. 2d 423, it was held that common stock, preferred stock, and securities entitled "certificates of indebtedness" issued by the cooperative had to be registered under the Kansas "Blue Sky Act," but that "Deferred Patronage Refund Certificates" issued to patrons did not have to be registered since their issuance for savings did not constitute a "sale" of a security.

<sup>26</sup> *Kirk v. Farmers' Union Grain Agency*, 103 Ore. 43, 202 P. 731; *Cannon v. Farmers' Union Grain Agency*, 103 Ore. 26, 202 P. 725.

<sup>27</sup> *National Bank of the Republic v. Price*, 65 Utah 57, 234 P. 231.

<sup>28</sup> *State v. Hudson*, 214 Mo. App. 260, 259 S. W. 877.

<sup>29</sup> *Klombies v. Weeks Poultry Community, Inc.*, 121 Cal. App. 175, 8 P. 2d 940.

<sup>30</sup> *National Bank of the Republic v. Price*, 65 Utah 57, 234 P. 231; *Hill v. Campbell*, 90 Ind. App. 687, 169 N. E. 865; *Weisendanger v. Lind*, 114 Kans. 523, 220 P. 263.

<sup>31</sup> *Morrison v. Farmers' Elevator Co.*, 319 Ill. 372, 150 N. E. 330.

<sup>32</sup> *Winfred Farmers' Company v. Smith*, 47 S. D. 498, 199 N. W. 477.

those who would purchase its stock in reliance upon some of its provisions.”<sup>33</sup>

It has been held that, where a cooperative sold stock without complying with the blue sky law of the State, on its liquidation by a receiver the purchaser and holder of such stock, on tendering it back, was to be treated as a general and not as a preferred creditor.<sup>34</sup>

When conveyances of property were made to a cooperative enterprise in exchange for its stock, without the corporation's complying with the blue sky laws of the State, it was held, in Oklahoma,<sup>35</sup> that such conveyances could not be set aside because of the grantor's acquiescence in the transaction for a number of years and his acceptance and retention of profits distributed by the corporation, and as the rights of the other stockholders would be adversely affected.

### **Name of Association**

It is essential that a corporation have a name under which it will transact its business. This is necessary for purposes of identification. Generally speaking the incorporators may select any name they choose for their corporation that is not an imitation of a name already used by a corporation engaged in a line of business similar to that in which the new corporation will be engaged. Statutory provisions in reference to this subject now exist in many States. These provisions frequently require that the name shall clearly indicate the corporation is incorporated. Sometimes the statutes require that the name shall include the word “corporation,” “incorporated,” or the abbreviation “Inc.” Restrictions prohibiting the adoption of a name already in use or so similar thereto as to be easily mistaken for it exist in many States. Under such a statute it was held that the Secretary of State of Washington was justified in refusing to file articles of incorporation for the “Kennewick Fruit Exchange” because of the similarity of its name to that of the “Kennewick District Fruit Growers' Association,” an existing corporation.<sup>36</sup>

Independent of statute, for one corporation to imitate the name of another corporation may constitute unfair competition, and if such is the case the courts will enjoin the corporation that is guilty of such imitation. In an Oregon case<sup>37</sup> it was said, “In any case, to entitle the complaining corporation to an injunction, the name used by defendant, when not the same as that of plaintiff, must be so similar thereto that, under all the circumstances of locality, business, etc., its use is in itself reasonably calculated to deceive the public and result in injury to plaintiff, or else it must be used fraudulently in such a way as to have that effect.” The court further said: “Injunction will be refused where no probability of deception by reason of the name is shown. Priority in adoption and use usually confers the superior right.”

A number of State statutes providing for the incorporation of farmer cooperatives contain provisions requiring the use of the word “cooperative”

<sup>33</sup> *National Cooperative Farm Loan Company v. Hirning*, 40 S. D. 448, 167 N. W. 1055.

<sup>34</sup> *Howard v. Corn Belt Farmers' Cooperative Association*, 225 Ill. App. 449. See also *Coe v. Portland Farmers' Elevator Company*, 236 Mich. 34, 209 N. W. 829.

<sup>35</sup> *Farmers' Union Cooperative Royalty Co. v. Little*, 182 Okla. 178, 77 P. 2d 33. See also *Farmers' Union Cooperative Royalty Company v. Southward*, 183 Okla. 402, 82 P. 2d 819.

<sup>36</sup> *State ex rel. Collins v. Howell*, 80 Wash. 649, 141 P. 1157.

<sup>37</sup> *Umpqua Broccoli Exch. v. Um-Qua Valley Broccoli Growers*, 117 Ore. 678, 245 P. 324. See also *Terry v. Cooper*, 171 Ark. 722, 286 S. W. 806, 48 A. L. R. 1254; *Drugs Consolidated, Inc. v. Drug Incorporated*, 16 Del. Ch. 240, 144 A. 656.



in the corporate name.<sup>38</sup> Many others permit the use of that word but do not require it. The statutes of a number of States prohibit the use of the word "cooperative" in the name of a corporation unless the corporation is in fact a cooperative or unless it is organized under that State statute. Some of these laws include a provision which permits corporations, organized under similar laws in other States, to use a corporate name with the word "cooperative" when admitted to do business in the State. Others have no such provision and in some cases the law is interpreted as prohibiting a cooperative, organized in another State and having the word "cooperative" in its name, from being admitted to do business in the State.<sup>39</sup> Accordingly, in organizing a cooperative, it may be advisable to omit the word "cooperative" from the name if the State statute permits, particularly if the corporation being organized plans to do business on a national scope.

The term "association" standing alone at common law and in the absence of a statute does not have a definite legal meaning. While it suggests an organization it gives no indication of whether the organization is incorporated or unincorporated.<sup>40</sup> Probably to many it suggests a corporation, and many of the statutes providing for the incorporation of a cooperative association state that the term means a corporation. But in the absence of a statute making it so, the term is not synonymous with corporation. The words "exchange," "union," and "company" likewise do not have an exact meaning, but to many they undoubtedly mean the same as the word "corporation," and in a number of the States statutes for the incorporation of cooperative associations provide that they are synonymous with the word "corporation."

## Charter

In the days when corporations were formed through application to the king, the paper or instrument issued by him, if he acted favorably on the application, was called the charter. It was evidence that a corporation had been formed and it stated the objects, powers, and limitations. Again, when corporations were created by special acts of the legislature,<sup>41</sup> the act setting forth similar facts was called the charter. At this time when corporations are created under general statutes, the formal instrument (whether called articles of association or articles of incorporation or certificate of incorporation) signed by those desirous of being incorporated, the incorporators, is commonly looked upon as the charter after its acceptance and approval by the official of the State to whom application for incorporation is made.

The charter is really much more than the articles of incorporation. It "consists of the provisions of the existing State constitution, the particular statute under which it is formed and all other general laws which are made applicable to corporations formed thereunder, and of the articles of association or incorporation filed thereunder, or the charter or certificate of incorporation granted by the court or officer in compliance with its terms;

<sup>38</sup> See sec. 22 of Bingham Cooperative Marketing Act of Kentucky, p. 306 of the Appendix. The Oregon Supreme Court, construing the 1913 cooperative law of that State, held that a provision forbidding the use of the term "cooperative" by a corporation already organized was unconstitutional as an impairment of the obligation of contracts. *Lornstsen v. Union Fishermen's Coop. Packing Co.*, 71 Ore. 540, 143 P. 621.

<sup>39</sup> Cf. *Tool Owners Union v. Roberts*, 76 N. Y. S. 2d 239, 190 Misc. 577.

<sup>40</sup> See *Millott v. Association of Mare Island Employees*, 187 Cal. 162, 201 P. 118.

<sup>41</sup> It is interesting to note that the Eastern Shore Produce Exchange, a cooperative organization of Onley, Va., was created by a special act of the general assembly of that State. See also *In re Litchfield County Agricultural Society*, 91 Conn. 536, 100 A. 356.



and its powers, rights, duties, and liabilities are determined accordingly.”<sup>42</sup> The foregoing definition makes it clear that the rights, powers, and liabilities of a corporation cannot be determined merely by reference to the articles of association and that the charter is something more than a paper.

Most cooperative statutes provide that the general corporation laws shall apply to cooperatives except where such provisions are in conflict with or inconsistent with the cooperative act.

In an Oklahoma case,<sup>43</sup> a general corporation statute prohibiting the retirement of stock was held inapplicable to the cooperative, since it would be inconsistent with the purposes of the cooperative statute to hold otherwise. An Ohio court held that an agricultural association, not having the power under the general code provisions applicable to such associations to guarantee the performance of a lease contract, did not acquire such power from a General Corporation Act which was subsequently passed.<sup>44</sup> The court thought the latter act should not be held to amend the earlier law dealing specifically with cooperatives unless expressly provided.

But the Supreme Court of Wisconsin has held<sup>45</sup> that a statute of the State which was part of the general corporation laws, and which forbade a corporation from doing business with persons other than its members before 50 percent of its capital stock had been subscribed and 20 percent of its authorized capital stock actually paid in, was applicable to a cooperative. The court reasoned that creditors of a cooperative were entitled to the same protection as afforded creditors of other corporations. Also, a general franchise tax on corporations was held applicable to an Ohio cooperative by reason of such a provision, after a provision of the cooperative act providing for a \$10 annual fee in lieu of franchise and similar taxes was repealed.<sup>46</sup>

It has been held that those dealing in stock of a cooperative are charged by law with knowledge of restrictions in its charter with respect thereto.<sup>47</sup>

Since the articles of association are a matter of public record, it has been held that the cooperative, its officers or employees, have no duty to furnish a copy to the members.<sup>48</sup>

Stockholders who consent to amendments to articles of incorporation or bylaws which decrease their rights are bound thereby.<sup>49</sup>

Illustrating the scope of amendments to charters, when the statute under which a corporation is formed provides in effect that an amendment may be adopted depriving stock previously issued of preferential rights attached thereto, such an amendment adopted in accordance with the statute is valid; but, if the statute does not authorize an amendment canceling accrued dividends on such stock, an amendment, insofar as it attempts to do so, is void.<sup>50</sup>

<sup>42</sup> 14 C. J. 117. See also, *De Mello v. Dairyman's Cooperative Creamery*, 73 Cal. App. 2d 746, 167 P. 2d 226.

<sup>43</sup> *Farmers Union Coop. Gin Co. v. Taylor*, 197 Okla. 495, 172 P. 2d 775.

<sup>44</sup> *24 East Sixth Street Corporation v. Cooperative Pure Milk Association*, 79 N. E. 2d 239 (Ohio).

<sup>45</sup> *Schoenburg v. Klapperich*, 239 Wis. 144, 300 N. W. 237.

<sup>46</sup> *Central Ohio Cooperative Milk Producers v. Glander*, 92 N. E. 2d 834 (Ohio Bd. of Tax Appeals).

<sup>47</sup> *Stuttgart Cooperative Buyers Association v. Louisiana Oil Refining Corporation*, 194 Ark. 779, 109 S. W. 2d 682. See also *Mayse v. Mineola Cooperative Exchange*, 139 Kan. 24, 30 P. 2d 120.

<sup>48</sup> *Indianapolis Dairymen's Cooperative, Inc. v. Bottema*, 226 Ind. 237, 79 N. E. 2d 399; 226 Ind. 260, 79 N. E. 2d 409.

<sup>49</sup> *Koeppler v. Crocker Chair Company*, 200 Wis. 476, 228 N. W. 130.

<sup>50</sup> *Keller v. Wilson & Company*, 180 A. 584, 190 A. 115, 194 A. 45 (Del. Ch.). See also; *Blumenthal v. Di Giorgio Fruit Corporation*, 30 Cal. App. 2d 11, 85 P. 2d 580, *Bay Newfoundland Company v. Wilson & Company*, 4 A. 2d 668 (Del.).

The articles of incorporation may not be amended without the consent or acquiescence of all the stockholders of the corporation, unless the power of amendment is reserved.<sup>51</sup> The power to amend may be reserved by the constitution or statutes of the State in which the corporation is formed or by its articles of incorporation.

A State may extend wide and comprehensive privileges with respect to the amendment of the charters of nonstock corporations as well as of stock corporations.<sup>52</sup>

It has been held that the articles of incorporation may not be changed by amendment so as to alter the original purpose for which the corporation was formed,<sup>53</sup> but in applying this rule the courts allow considerable latitude.<sup>54</sup>

An association should confine its operations to those activities authorized by its charter. If an association, for instance, is incorporated to handle one kind of tobacco, it is without authority to handle another kind.<sup>55</sup> If an association under the statute under which it is formed may do business only with members, it is without authority to do business with nonmembers.<sup>56</sup> An electric cooperative, formed to operate as a Rural Electrification Administration borrower and having no charter power to engage in the business of furnishing water to anyone, cannot lawfully contract to purchase an existing facility which has water distribution properties as well as electric transmission and distribution lines.<sup>57</sup>

If an association engages in a business or activity not authorized by its charter, any member of the association who does not consent thereto can obtain an injunction restraining the directors and officers from such course of action.<sup>58</sup> In addition, the State can prevent the unauthorized business and, in a proper case, can revoke the charter of the association on account thereof.<sup>59</sup> At least in cases tried in Federal courts, the fact that an association is acting *ultra vires* may adversely affect its rights. A livestock association transacted business with nonmembers in violation of its charter and the Supreme Court of the United States held that the association could not successfully complain of a boycott by dealers in livestock, insofar as the nonmember business was concerned.<sup>60</sup>

An association has implied authority to enter into such contracts and business transactions as are usual or necessary for carrying into effect the exercise of its specific powers, provided they are not inconsistent with the charter or prohibited by statute or public policy.<sup>61</sup>

<sup>51</sup> Fletcher CYCLOPEDIA CORPORATIONS, Perm. Ed., sec. 3726.

<sup>52</sup> *Gulcz v. Delaware Polish Beneficial Association*, 20 Del. Ch. 52, 169 A. 595.

<sup>53</sup> *Midland Cooperative Wholesale v. Range Cooperative Oil Association*, 200 Minn. 538, 274 N. W. 624, 111 A. L. R. 1521.

<sup>54</sup> *Power v. Provo Bench Canal & Irrigation Company*, 99 Utah 267, 101 P. 2d 375, certiorari denied, 313 U. S. 564, 61 S. Ct. 841, 85 L. Ed. 1523; *Martin Orchard Company v. Fruit Growers Canning Company*, 203 Wis. 97, 233 N. W. 603.

<sup>55</sup> *Brame v. Dark Tobacco Growers' Cooperative Association*, 212 Ky. 185, 278 S. W. 597.

<sup>56</sup> *United States v. American Livestock Commission Co.*, 279 U. S. 435, 49 S. Ct. 425, 73 L. Ed. 787. Cf. *Petition of White Mountain Power Co.*, 96 N. H. 144, 71 A. 2d 496.

<sup>57</sup> *Trico Electric Cooperative, Inc. v. Ralston*, 67 Ariz. 358, 196 P. 2d 470.

<sup>58</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Galloway v. Mitchell County Electric Membership Corporation*, 190 Ga. 428, 9 S. E. 2d 903.

<sup>59</sup> *People ex rel. Clark v. Milk Producers' Association of Central California, Inc.*, 60 Cal. App. 439, 212 P. 957; *Bowles v. Inland Empire Dairy Association*, 53 F. Supp. 210.

<sup>60</sup> *United States v. American Livestock Commission Co.*, 279 U. S. 435, 49 S. Ct. 425, 73 L. Ed. 787.

<sup>61</sup> *Kasch v. Farmers' Gin Company*, 3 S. W. 2d 72 (Tex. Com. App.); 13 Am. Jur. 773.

It is believed that all the States have provisions in their statutes or constitutions covering the revocation of charters of corporations. Independent of such provisions, it is generally held that, if an association or other corporation violates the laws of the State, in the conduct of its affairs, the State that granted the charter may revoke it.<sup>62</sup> Those receiving the charter accept it on the implied condition that it will be used for lawful purposes only. It is apparent that a State would never create a corporation to violate its laws; hence revocation of a charter for the violation of such laws appears reasonable.

There are statutes in many States under which a charter which expires at the end of a given period may be renewed. In some instances these statutes require those voting for renewal to purchase the stock of those voting against renewal.<sup>63</sup>

A State may, by quo warranto proceedings, inquire into the question whether a corporation, cooperative or otherwise, is exceeding or unlawfully exercising its powers.

In a quo warranto proceeding<sup>64</sup> involving a cooperative, it was said:

It certainly is a matter of public concern that a corporation, under the color or guise of a nonprofit concern, is usurping the functions of an ordinary corporation by employing its capital to engage in business for a profit, and is combining with others in the illegal restraint of trade.

### De Facto Corporations

As previously pointed out, the incorporation and organization of a cooperative is a matter demanding careful and competent attention. It is imperative that all requirements be met and that all prerequisites to beginning business be observed.

If the incorporators of an association fail to include in their articles of incorporation all the provisions required by the statute under which they are attempting to incorporate, or if the incorporators fail to observe other statutory requirements for incorporation, the general rule in all jurisdictions is that the State may maintain quo warranto proceedings against the association and thus cause a cancelation of its charter.<sup>65</sup>

Again, there are instances in which members have been held liable as partners because of defects in the incorporation and organization of corporations. In an Iowa case,<sup>66</sup> decided in 1929, it was held "that the failure of the Secretary of State to properly certify that he accepted the articles

<sup>62</sup> *State ex. inf. Hadley v. Delmar Jockey Club*, 200 Mo. 34, 92 S. W. 185, 98 S. W. 539; *State ex rel. Crabbe v. Thistle Down Jockey Club*, 114 Ohio St. 582, 151 N. E. 709.

<sup>63</sup> *Terrell v. Ringgold County Mutual Telephone Co.*, 225 Iowa 994, 282 N. W. 702; *Apsey v. Kimball*, 221 U. S. 514, 31 S. Ct. 695, 55 L. Ed. 834. See also *Ervin v. Oregon Railway & Navigation Company*, 27 F. 625.

<sup>64</sup> *People ex rel. Clark v. Milk Producers' Association of Central California, Inc.*, 60 Cal. App. 439, 212 P. 957, 958.

<sup>65</sup> 13 Am. Jur., P. 192, sec. 45; *People v. Montecito Water Company*, 97 Cal. 276, 32 P. 236, 33 Am. St. Rep. 172 and note thereto.

<sup>66</sup> *Wilkin Grain Co. v. Monroe County Coop. Association*, 208 Iowa 921, 223 N. W. 899, 902; 225 N. W. 868. For other cases in which stockholders have been held liable as partners because of defective incorporation see: *Bergeron v. Hobbs*, 96 Wis. 641, 71 N. W. 1056; *Hughes Company v. Farmers' Union Produce Company*, 110 Neb. 736, 194 N. W. 872, 37 A. L. R. 1314; *Fatzer v. K. & N. Inc.* (New Jersey Department of Labor—Workmen's Compensation Bureau), 191 A. 291, 15 N. J. Misc. 379; *Ogden Packing & Provision Co. v. Wyatt*, 59 Utah 481, 204 P. 978, 22 A. L. R. 359. See also: *Swofford Bros. Dry Goods Company v. Owen*, 37 Okla. 616, 133 P. 193, L. R. A. 1916C 189 and note thereto; 13 Am. Jur., p. 192, sec. 45; and DEFECTIVE FORMATION AND SUITS IN THE CORPORATE NAME, 84 U. Pa. L. Rev. 514 (1936).



of incorporation was sufficient to and did prevent the institution from becoming a de jure corporation, and made of it a de facto status only."

A creditor who had not dealt with the corporation as a corporation recovered from stockholders of the corporation as partners. The court said: "Due to the defects of organization, notice of the incorporation was not constructively imparted."

In some jurisdictions liability is imposed by statute upon the members, as partners or otherwise, of an organization which has been defectively formed.<sup>67</sup> In some States stockholders or officers of a corporation are liable for its debts if the corporation begins business before the requisite amount of capital has been subscribed.<sup>68</sup>

In general, if incorporators of an organization proceed with its incorporation to a stage where a de facto corporation results, the incorporators and stockholders are not personally liable for corporate obligations.<sup>69</sup> In order to have a de facto corporation there must be "(1) a valid law under which a corporation with the powers assumed might be incorporated; (2) a bona fide attempt to organize a corporation under such law; and (3) an actual exercise of corporate powers."<sup>70</sup> Difficulties and differences of opinion arise in determining if the steps taken by incorporators and the circumstances involved result in a de facto corporation.<sup>71</sup>

Aside from the danger of members of a defectively incorporated organization being held personally liable for debts of the organization, it is believed that a cooperative which is imperfectly organized would be unable to enforce marketing agreements and subscriptions for stock which were signed or made prior to incorporation, because the persons have not contracted to become members of a defective organization.<sup>72</sup>

## Bylaws

The adoption of bylaws is a matter to be taken up after the creation of an association. The power of a corporation to make bylaws exists at common law. Frequently, however, it is given by the charter or statutes. The statutes of some of the States require that cooperatives shall adopt bylaws within a certain length of time after their formation. In the absence of a statutory requirement it is not necessary, although highly desirable, for an association to adopt bylaws. The power to adopt bylaws resides in the stockholders or members, and they alone have the power to adopt them in the absence of a provision in the general law or in the charter, placing such power in the hands of a particular body.

If the statute under which an association is incorporated authorizes the making of bylaws on specific subjects, barring constitutional questions, the association may adopt bylaws covering those subjects, but even where the power to adopt bylaws is thus expressly conferred the bylaws should be reasonable and fair.<sup>73</sup>

<sup>67</sup> 13 Am. Jur., p. 200, sec. 57.

<sup>68</sup> 13 Am. Jur., p. 202, sec. 59; *Schoenburg v. Klapperich*, 239 Wis. 144, 300 N. W. 237.

<sup>69</sup> 13 Am. Jur., p. 201, sec. 58.

<sup>70</sup> 13 Am. Jur., p. 195, sec. 49.

<sup>71</sup> *Hughes Company v. Farmers' Union Produce Company*, 110 Neb. 736, 194 N. W. 872, 37 A. L. R. 1314.

<sup>72</sup> 13 Am. Jur., p. 210, sec. 67; *Byronville Creamery Association v. Ivers*, 93 Minn. 8, 100 N. W. 387. See also *State ex rel. Havner, Attorney General v. Associated Packing Company*, 216 Iowa 1344, 249 N. W. 761, 90 A. L. R. 1339; but see *Farmers' Mutual Telephone Company v. Howell*, 132 Iowa 22, 109 N. W. 294 (strong dissenting opinion).

<sup>73</sup> *Oyster v. Slovene National Benevolent Society of U. S. A.*, 154 Misc. 19, 278 N. Y. S. 320.

Statutory requirements and limitations should be complied with, and bylaws in conflict with them fail.<sup>74</sup> Even where bylaws are adopted by unanimous consent of all the stockholders they have been held void if in conflict with the statute.<sup>75</sup> It has been held that a bylaw which is not within the limitations of the statute under which the association is incorporated, is invalid at least as to third persons.<sup>76</sup> A bylaw is void if it contravenes limitations in the State or Federal constitution.<sup>77</sup> A bylaw that is valid when made may be rendered invalid by a statute subsequently adopted.<sup>78</sup>

The purpose of bylaws is to provide rules for the regulation of the affairs of the corporation.<sup>79</sup> They can make provisions consistent with law and with the charter for any matter or thing relative to the conduct or business of the corporation. For instance, independent of statute, it has been held that bylaws may provide for liquidated damages,<sup>80</sup> a subject that will be discussed later. A bylaw has been upheld which provided that action taken by the board of directors should, on petition of a percentage of the members, be submitted to them for approval or rejection.<sup>81</sup>

The courts upheld as reasonable, bylaws relative to the nomination of candidates for the office of director, providing <sup>82</sup>—

for nominations: First, by the nominating committee of the association, to be posted not less than 2 weeks prior to the annual meeting; second, by independent nominations, to be posted not less than 5 days prior to such meeting; and, finally, that "no candidates for directors shall be balloted for, other than those proposed in either one of these two ways."

It has been held that a cooperative, in the absence of specific statutory authority therefor, may adopt a bylaw under which the association is obligated to repurchase its stock under specified conditions.<sup>83</sup> Bylaws should perform the same function for a corporation or association that a blueprint performs for a builder. They should constitute a working plan for the corporation. Among the matters usually provided for in the bylaws of a corporation are the following: Eligibility requirements for membership; restrictions on the transfer of stock or membership; the right to make specified deductions; provisions for expelling or suspending the rights of members; the time, place, and manner of calling and conducting meetings and the giving of notice thereof; the number of members constituting a quorum; the qualifications, terms of office, and duties of directors and officers and their compensation, if any; and suitable penalties for violation

<sup>74</sup> *Oklahoma Cotton Growers' Association v. Salyer*, 114 Okla. 77, 243 P. 232; *Noble v. California Prune & Apricot Growers' Association*, 98 Cal. App. 230, 276 P. 636; *Security Savings & Trust Company v. Coos Bay Lumber & Coal Company*, 219 Wis. 647, 263 N. W. 187; *Tapo Citrus Association v. Casey*, 45 Cal. App. 2d 796, 115 P. 2d 203; *Lee v. Farmers Coop. Association of Mountain View*, 189 Okla. 55, 113 P. 2d 391.

<sup>75</sup> *Gaskill v. Gladys Belle Oil Company*, 16 Del. Ch. 289, 146 A. 337; *Security Savings & Trust Company v. Coos Bay Lumber & Coal Company*, 219 Wis. 647, 263 N. W. 187.

<sup>76</sup> *Lewis v. Monmouth County Farmers' Cooperative Association*, 105 N. J. Eq. 257, 147 A. 550.

<sup>77</sup> *Spayd v. Ringing Rock Lodge No. 665*, 270 Pa. 67, 113 A. 70, 14 A. L. R. 1443.

<sup>78</sup> *Grisim v. South St. Paul Live Stock Exchange*, 152 Minn. 271, 188 N. W. 729.

<sup>79</sup> *Diedrick v. Helm*, 217 Minn. 483, 14 N. W. 2d 913.

<sup>80</sup> *Ex parte Baldwin County Producers' Corporation*, 203 Ala. 345, 83 So. 69.

<sup>81</sup> *Callaway v. Farmers Union Cooperative Association of Fairbury*, 119 Neb. 1, 226 N. W. 802.

<sup>82</sup> *In re O'Shea*, 241 App. Div. 699, 269 N. Y. S. 840.

<sup>83</sup> *Loch v. Paola Farmers' Union Cooperative Creamery & Store Association*, 130 Kan. 136, 285 P. 523, rehearing denied, 130 Kan. 522, 287 P. 269. See also *Whitney v. Farmers' Coop. Grain Co.*, 110 Neb. 157, 193 N. W. 103.

of the bylaws. A bylaw must be general in its application and not aim at a particular member.<sup>84</sup> Where stock in a mutual ditch company was acquired after ascertaining that the company did not have a bylaw prohibiting the transfer of water from one tract of land to another without the approval of the board of directors, a bylaw adopted by the board of directors immediately after the acquisition of such stock, prohibiting such a transfer, was held arbitrary and unreasonable.<sup>85</sup>

Bylaws should be distinguished from rules adopted for the guidance of the public dealing with the association. The members of a corporation and its directors and officers usually are conclusively presumed to have notice of bylaws, and of what they contain, and hence are bound by them, although, as a fact, they may be ignorant of them.<sup>86</sup> Also, persons who join an association and pay dues in accordance with bylaws which have been in effect since organization, even though such bylaws are inconsistent with the charter, are estopped from questioning the validity of such bylaws.<sup>87</sup>

The great importance of members, officers, and directors knowing the provisions of the bylaws of their association is thus apparent. On the other hand, strangers having no knowledge of bylaws are not bound by them unless perhaps in States where specifically authorized by statute.<sup>88</sup>

If notice of bylaws, either actual or constructive, reaches strangers the bylaws usually are held to be binding on them.<sup>89</sup>

In some States it is held that where the statute or the charter provides that a given power shall be exercised by particular officers or agents of the corporation, the power can be exercised only by such officers or agents and that a bylaw providing otherwise is void.<sup>90</sup> On the other hand, it has been held, at least as to third persons, that the board of directors may confer the authority to do certain acts on persons other than those who the bylaws stipulate shall exercise such authority.<sup>91</sup>

A question which will readily occur to anyone is whether the majority of the members of an association may adopt bylaws which will be binding upon the minority who oppose their adoption.<sup>92</sup> The answer is "Yes," if such bylaws are reasonable and consistent with the charter and the general law. Herein lies an important difference between bylaws and contracts. A valid bylaw is binding upon a member or stockholder although he opposed its adoption, but assent is necessary to the creation of a contract. A majority of the members cannot adopt and enforce bylaws which violate the law or run counter to the purpose for which the association was formed. If an association represented that a bylaw was in effect, although it was

<sup>84</sup> *Budd v. Multnomah St. Ry. Co.*, 15 Ore. 413, 15 P. 659, 3 Am. St. Rep. 169.

<sup>85</sup> *Costilla Ditch Company v. Excelsior Ditch Company*, 100 Colo. 433, 68 P. 2d 448.

<sup>86</sup> *Washington Coop. Egg & Poultry Association v. Taylor*, 122 Wash. 466, 210 P. 806; *Brent v. Bank of Washington*, 10 Pet. 596, 35 U. S. 596, 9 L. Ed. 547; *Columbia Bldg. & Loan Association v. Junquist*, 111 F. 645.

<sup>87</sup> *State v. Bankston*, 7 So. 2d 667 (La.).

<sup>88</sup> *McKinney v. Mechanics' Trust & Savings Bank*, 222 Ky. 264, 300 S. W. 631.

<sup>89</sup> *Harley v. Hartford Fruit Growers' & Farmers' Exchange*, 216 Mich. 146, 184 N. W. 507; *Rathbun v. Snow*, 123 N. Y. 343, 25 N. E. 379, 10 L. R. A. 355; *Iowa-Missouri Grain Co. v. Powers*, 198 Iowa 208, 196 N. W. 979, 33 A. L. R. 1268; *Rundell v. Farmers' Cooperative Elevator Co. of Corunna*, 210 Mich. 642, 178 N. W. 21.

<sup>90</sup> *Security Savings & Trust Company v. Coos Bay Lumber & Coal Company*, 219 Wis. 647, 263 N. W. 187; *Maasdam v. Jefferson County Farmers' Mutual Insurance Association*, 222 Iowa 162, 268 N. W. 491.

<sup>91</sup> *Keenan v. Zemaitis*, 4 F. 2d 572; *Sealy Oil Mill & Manufacturing Company v. Bishop Manufacturing Company*, 235 S. W. 850 (Tex. Com. App.).

<sup>92</sup> *Iowa State & Savings Bank v. City Nat. Bank*, 106 Neb. 397, 183 N. W. 982; *Kelly v. Republic Building & Loan Association*, 34 S. W. 2d 924 (Tex. Civ. App.).



adopted by only a majority vote where a two-thirds vote of the members, or their written assent, was required, the association may be estopped from denying that it is not valid as against members who have relied on the bylaws.<sup>93</sup>

In an Arkansas case, a majority of the members of a corporation sought through a bylaw to make what, under the circumstances, was held to be an attempted gift of a sum of money to one of their members. Certain stockholders of the corporation opposed the bylaw and later resorted to the courts to prevent the turning over of the money. It was held that the action contemplated was a distinct violation of their rights and was therefore illegal.<sup>94</sup>

The fact that a person at the time he becomes a member of an association agrees to be bound by all present and future bylaws does not permit the association to adopt bylaws which will deprive him of vested rights under the bylaws which were in effect when he became a member.<sup>95</sup> For instance, if an association at the time a person acquires stock therein agrees that it will refund the purchase price if he leaves the community and it has a bylaw to this effect, the fact that the shareholder agrees to be bound by all present and future bylaws does not permit the association to adopt a bylaw abrogating the arrangement as to him;<sup>96</sup> but agreements to abide by future bylaws will be given effect in certain types of cases.<sup>97</sup> A bylaw obligating an association to repurchase its shares under given conditions constitutes "a contract with the corporation which could not be abrogated by simple repeal of the bylaw"<sup>98</sup> at least as against a member who did not concur therein. Where a member did not vote in favor of a bylaw which affected his existing and future financial rights, but did not object to deductions made in accordance with the bylaw but apparently acquiesced therein, he was bound thereby.<sup>99</sup> In a later section of this publication will be discussed the extent to which the association may, by adopting suitable bylaws, restrict the transfer of stock previously issued.<sup>1</sup>

If a member voted in favor of repealing a bylaw or of adopting one that adversely affected his interests under bylaws in effect when he became a member, he would be estopped from challenging its validity.<sup>2</sup>

If a statute<sup>3</sup> or bylaw<sup>4</sup> provides for action by the board of directors, the same action taken by the manager will not be binding on the association. Again, where the statute under which a mutual insurance company was incorporated, and its bylaws, required applications for insurance to be in writing, the insurance company was not liable for a loss in a case in which

<sup>93</sup> *Buford v. Florin Fruit Growers' Association*, 210 Cal. 84, 291 P. 170.

<sup>94</sup> *Jones Lumber Co. v. Wisarkana Lumber Co.*, 125 Ark. 65, 187 S. W. 1068.

<sup>95</sup> *Farrier v. Ritzville Warehouse Co.*, 116 Wash. 522, 199 P. 984; *Jaeger v. Grand Lodge, Order of Hermann's Sons*, 149 Wis. 354, 135 N. W. 869, 39 L. R. A. (N. S.) 494; *Model Land & Irrigation Co. v. Madsen*, 87 Colo. 166, 285 P. 1100.

<sup>96</sup> *Whitney v. Farmers' Coop. Grain Co.*, 110 Neb. 157, 193 N. W. 103.

<sup>97</sup> *Kelsey v. Early Grain & Elevator Company*, 206 S. W. 849 (Tex. Civ. App.).

<sup>98</sup> *Loch v. Paola Farmers' Union Cooperative Creamery & Store Association*, 130 Kan. 136, 285 P. 523, rehearing denied, 130 Kan. 522, 287 P. 269. See also *Whitney v. Farmers' Coop. Grain Co.*, 110 Neb. 157, 193 N. W. 103; *Adams v. Sanford Growers' Credit Corporation*, 135 Fla. 513, 186 So. 239.

<sup>99</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190. See also *Searles v. Bar Harbor Banking & Trust Company*, 128 Me. 34, 145 A. 391, 65 A. L. R. 1154.

<sup>1</sup> Reorganization of Associations, p. 62.

<sup>2</sup> *Farrier v. Ritzville Warehouse Co.*, 116 Wash. 522, 199 P. 984; *Kent v. Quick-silver Mining Co.*, 78 N. Y. 159, 12 Hun. 53; *Morrison v. Dorsey*, 48 Md. 461.

<sup>3</sup> *Scott v. Marin*, 22 F. 2d 779.

<sup>4</sup> *Farmers' Coop. Mercantile Co. v. Shultz*, 113 Neb. 801, 205 N. W. 288.

a member, without complying with the bylaws, left his insurance policy with the secretary of the company, requesting that he renew it.<sup>5</sup>

A bylaw of an association purporting to impose personal liability on members for its debts has been held void if the charter of the association or the statute under which it was formed did not authorize such a bylaw.<sup>6</sup> All authorities agree that under no circumstances can an unauthorized "bylaw" impose any liability on members who did not vote therefor or acquiesce therein.<sup>7</sup>

Although an act authorized the inclusion in the articles of incorporation of an association of provisions restricting the liability of members, it was held that bylaws purporting to restrict such liability were void where no limitation was contained in the articles of incorporation and the adoption of bylaws was restricted to matters "within the limitations of this act."<sup>8</sup>

If a bylaw provides for the automatic termination of membership upon failure or neglect to deliver products, a member cannot, by refusing to deliver, terminate his membership unless the association consents thereto.<sup>9</sup> Such a bylaw is for the association's benefit; furthermore, the maxim that no man may take advantage of his own wrong would seem to apply. The fact that the statute under which a cooperative was incorporated authorized the members to adopt a bylaw delegating to its board of directors the right to expel members did not authorize the board of directors to expel members where no such bylaw had been adopted.<sup>10</sup>

Propositions embodied in valid bylaws are as binding on the members of an association as if included in the marketing contract. It has been held that where the place of performance of a marketing contract is stated in a bylaw by which the member has agreed to be bound, it is as effectual as though it were stated in the marketing contract.<sup>11</sup> An egg association, acting in accordance with a bylaw, allowed members to sell their eggs outside the association under specified conditions and, in a suit on its marketing contract by the association against a member who failed to comply with such conditions, the court held that the bylaw was valid and virtually a part of the contract.<sup>12</sup>

Where deductions from proceeds received from the sale of commodities were made by an association on the basis of a percentage of sales proceeds, instead of on a tonnage basis, a member of the association who was aware of the deduction method followed and who did not object thereto was held to have acquiesced in the bylaw providing therefor.<sup>13</sup>

Statutory provisions with respect to bylaws should be observed. In Oklahoma it has been held that if the statute under which an association is formed authorizes it to adopt a bylaw requiring members to sell all their

<sup>5</sup> *Smith v. Miami Farmers' Mutual Fire Insurance Company*, 125 Kan. 10, 262 P. 552.

<sup>6</sup> *Mitcham, et al. v. Citizens' Bank of Bullochville*, 34 Ga. App. 707, 131 S. E. 181, 136 S. E. 798; *Monroe Dairy Association v. Webb*, 40 App. Div. 49, 57 N. Y. S. 572. See also *Farmers' Coop. Union v. Alderman*, 126 Kan. 299, 267 P. 1110.

<sup>7</sup> 10 Cyc. 357.

<sup>8</sup> *Lewis v. Monmouth County Farmers' Cooperative Association*, 105 N. J. Eq. 257, 147 A. 550.

<sup>9</sup> *California Bean Growers' Association v. Rindge Land & Nav. Co.*, 199 Cal. 168, 248 P. 658; *Milk Producers' Association v. Webb*, 97 Cal. App. 650, 275 P. 1001.

<sup>10</sup> *State ex rel. Boldt v. St. Cloud Milk Producers' Association*, 200 Minn. 1, 273 N. W. 603.

<sup>11</sup> *East-West Dairymen's Association v. Dias*, 59 Cal. App. 2d 437, 138 P. 2d 772.

<sup>12</sup> *Washington Coop. Egg & Poultry Association v. Taylor*, 122 Wash. 466, 210 P. 806.

<sup>13</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190.

products through the association and also one providing for liquidated damages upon condition that a bylaw is adopted giving members an opportunity to withdraw, failure to adopt a bylaw providing for withdrawal voids bylaws adopted on the other two subjects and renders the marketing contracts of the association unenforceable.<sup>14</sup> It has been held that failure to adopt bylaws within the time provided by statute may not be used as a defense to a suit brought by an association against a member on his contract.<sup>15</sup> Where the State statute provided that the bylaws could be changed only by the vote or the written assent of a numerical majority of the members of the association, an attempted amendment which did not get the required vote or assent was held invalid.<sup>16</sup>

The Supreme Court of Kansas held that a bylaw reading "At any meeting a majority of the members present in person or represented by proxy shall constitute a quorum for all purposes, including the election of directors, except when otherwise provided by law" meant that a majority of all the members of an association must be present in person or be represented by proxy at meetings of the association to authorize it to transact business.<sup>17</sup>

Because it indicates the possible scope of bylaws, a Nebraska case is interesting. It was held that a corporation not organized for profit and whose capital stock was fully paid up could lawfully require annual dues from its members.<sup>18</sup> A bylaw of a labor union was held to prevent a former member of the union from soliciting customers of a former employer.<sup>19</sup>

Where a stockholder apparently had not acquiesced in a bylaw of an association, incorporated under a general incorporation act purporting to require stockholders to deliver milk daily, it was held invalid; but it was suggested that such a bylaw might have been effective if the association had been incorporated under the cooperative act.<sup>20</sup> Hop growers were not entitled to cancellation of hop marketing contracts entered into with the cooperative on the ground that the cooperative refused to permit growers to withdraw from membership on serving notice of withdrawal in accordance with bylaw, where the bylaw regarding withdrawal had never been approved by a sufficient number of members of the corporation.<sup>21</sup>

Nonusage of a bylaw continuing for a period of time and brought home to the members has been held to work an abrogation thereof.<sup>22</sup>

Where the statute is silent as to the manner of adopting bylaws, it has been held that they may be adopted or modified either orally or in writing or by uniform usage and acquiescence.<sup>23</sup>

An invalid bylaw, as such, creates no liability, but if not opposed to public policy is generally enforced as a contract between the members and between the corporation and its members. For instance, if the members of an association adopt what purports to be a bylaw, but which is void for the reason that the corporation or association is not empowered by the law of

<sup>14</sup> *Oklahoma Cotton Growers' Association v. Salyer*, 114 Okla. 77, 243 P. 232; *McLain v. Oklahoma Cotton Growers' Association*, 125 Okla. 264, 258 P. 269.

<sup>15</sup> *Tennessee Cotton Growers' Association v. Hanson*, 2 Tenn. App. 118; *Boyle v. Pasco Growers' Association, Inc.*, 170 Wash. 516, 17 P. 2d 6.

<sup>16</sup> *Tapo Citrus Association v. Casey*, 45 Cal. App. 2d 766, 115 P. 2d 203.

<sup>17</sup> *Everts v. Kansas Wheat Growers' Association*, 119 Kan. 276, 237 P. 1030.

<sup>18</sup> *Omaha Law Library Association v. Connell*, 55 Neb. 396, 75 N. W. 837.

<sup>19</sup> *Western-United Dairy Company v. Nash*, 293 Ill. App. 162, 12 N. E. 2d 47.

<sup>20</sup> *Monroe Dairy Association v. Webb*, 40 App. Div. 49, 57 N. Y. S. 572.

<sup>21</sup> *Beaulaurier v. Washington State Hop Producers, Inc.*, 8 Wash. 2d 79, 111 P. 2d 559.

<sup>22</sup> *Huxtable v. Berg*, 98 Wash. 616, 168 P. 187; *Pomeroy v. Westaway*, 70 N. Y. S. 2d 449; *Elliott v. Lindquist*, 356 Pa. 385, 52 A. 2d 180.

<sup>23</sup> *Beazell v. Farmers' Mutual Insurance Company of Livingston County*, 214 Mo. App. 430, 253 S. W. 125.



the State in which it is incorporated or by its charter to adopt the particular bylaw, it will, as a general rule, be enforced as a contract among those members who voted therefor or consented thereto.<sup>24</sup> A bylaw providing for the forfeiture of the stock of members for failing to deliver their commodities to an association has been upheld as a contract.<sup>25</sup> In the case of unincorporated associations, "A provision for expulsion, although unreasonable as a bylaw as being against common right, may, if assented to by a member, be binding on him as a contract."<sup>26</sup>

Even though a rural electric cooperative had a bylaw providing that under certain conditions it would reimburse a member for the cost of a transmission line built by him, it was held that this did not prevent the association from entering into a special agreement with an applicant for membership differing from the terms of the bylaw, the court emphasizing that membership in the cooperative was not a matter of right.<sup>27</sup>

Legal liabilities may result from a failure of officers and directors to observe bylaws.<sup>28</sup> They, as well as the managers, are in law simply agents, and agents are bound by the instructions of their principals. Ordinarily bylaws are adopted by the members of an association, and they constitute instructions, rules or restrictions for the management of an association. Even in a case<sup>29</sup> in which the bylaws were adopted by the directors, the court, in a suit brought against the manager who was also a director, said:

The board of directors could not bind the association by any ratification of transactions which the bylaws expressly prohibited, because the bylaws applied as much to the directors as to the defendant, and furnished the rules of conduct for all officers of the association.

Cooperatives engaged in handling grain generally have bylaws prohibiting the manager or any officer from speculating in grain; and if a loss follows from a violation of such a bylaw, the association may recover.<sup>30</sup>

The term "constitution" is frequently used in connection with bylaws. So far as an incorporated association is concerned, the expression has no place. Incorporated associations have articles of incorporation (charters) but do not have constitutions. The use of the term with respect to incorporated associations only creates confusion. A "constitution" has been held to be only an inappropriate name for a bylaw.<sup>31</sup>

## Liability of Association for Promotion Expenses

What is the liability of a corporation on contracts made or obligations incurred by its promoters or those who are active in forming and organizing it? The answer is that, as a general rule, it is not liable unless after its formation it recognizes and ratifies the contracts or obligations. This question arises in connection with the work done or contracts made incident to the promotion of a corporation and prior thereto by those who are active in bringing about the existence of the corporation.

<sup>24</sup> *Strong v. Minneapolis Automobile Trade Association*, 151 Minn. 406, 186 N. W. 800; *New England Trust Co. v. Abbott, Exr.*, 162 Mass. 148, 38 N. E. 432, 27 L. R. A. 271; *Searles v. Bar Harbor Banking & Trust Company*, 128 Me. 34, 145 A. 391, 65 A. L. R. 1154.

<sup>25</sup> *Bessette v. St. Albans Cooperative Creamery*, 107 Vt. 103, 176 A. 307.

<sup>26</sup> *Elfer v. Marine Engineers Beneficial Association No. 12*, 179 La. 383, 154 So. 32; 5 C. J. 1355.

<sup>27</sup> *Ford v. Peninsula Light Company*, 164 Wash. 599, 4 P. 2d 504.

<sup>28</sup> *Dome Realty Co. v. Rottenberg*, 285 Mass. 324, 189 N. E. 70.

<sup>29</sup> *Hoffman v. Farmers' Coop. Shipping Association*, 78 Kan. 561, 97 P. 440, 443. See also 7 R. C. L. sec. 426.

<sup>30</sup> *Hoffman v. Farmers' Coop. Shipping Association*, 78 Kan. 561, 97 P. 440.

<sup>31</sup> *Supreme Lodge K. of P. v. Kutscher*, 179 Ill. 340, 53 N. E. 620.

In a North Dakota case,<sup>32</sup> in which the claim involved arose out of work done by a stock subscription solicitor in obtaining subscribers to the capital stock of a corporation to be organized, it was said:

It is elementary that a corporation is not liable upon contracts entered into by its promoters. Before the corporation comes into existence, it can have no representative, and no one is capable of acting for it. Those interested in promoting it may nevertheless contemplate the ultimate payment by the corporation of the legitimate promotion expenses. But the corporation does not become liable for such expenses, in the absence of a subsequent undertaking in some form.

In a Montana case<sup>33</sup> appears the following:

In the absence of statute, a corporation will be held liable for services rendered by its promoters before incorporation, only when by express action taken after it becomes a legal entity it recognizes or affirms such claim; and a mere silence of the board of directors, or failure to object when the claim is mentioned, is not such an assumption or adoption as will bind the corporation.

It is true that, as a rule, a corporation usually pays the necessary legitimate expenses and costs incurred by those who brought about its formation, but the corporation is not liable for such charges unless it elects to pay them.<sup>34</sup> On the other hand, of course the promoters are liable for such expenses and costs and may, in addition, be liable for injuries to their employees and others.<sup>35</sup>

### Limitation on Indebtedness

The common law places no limit upon the amount which a corporation may borrow. The amount borrowed may be greater than the capital stock.<sup>36</sup> The general rule is that a debt contracted by a corporation in excess of the limit fixed by statute or by the charter is valid and enforceable against the corporation. A national bank purchased furniture and executed three promissory notes in payment thereof at a time when the amount of its indebtedness exceeded that allowed by a Federal statute. In a suit brought on the notes it was held that the notes were enforceable against the bank. In this case, it was said, "We hold, therefore, that an indebtedness which a national bank incurs in the exercises of any of its authorized powers, and for which it has received and retains the consideration, is not void from the fact that the amount of the debt surpasses the limit prescribed by the statute, or is even incurred in violation of the positive prohibition of the law in that regard."<sup>37</sup> In an Iowa case<sup>38</sup> it was said, "A corporate debt contracted in excess of the maximum limitation in its articles of incorporation is not void because of such excess." In the case of a corporation there are no public records by which one about to extend credit to it can ascertain the amount of indebtedness already incurred at the time credit is extended, and this furnishes a sufficient reason for holding a corporation liable in cases like those just discussed.

As pointed out elsewhere, officers and directors are liable to the corporation for all damages suffered by it if they exceed the limit of indebtedness fixed by the statute, charter, or bylaws. And directors and officers are made

<sup>32</sup> *Davis v. Joerke*, 47 N. D. 39, 181 N. W. 68, 70.

<sup>33</sup> *Kirkup v. Anaconda Amusement Co.*, 59 Mont. 469, 197 P. 1005, 1007, 17 A. L. R. 441; *Cushion Heel Shoe Co. v. Hartt*, 181 Ind. 167, 103 N. E. 1063, 50 L. R. A. (N. S.) 979.

<sup>34</sup> *Kridelbaugh v. Aldrehn Theatres Co.*, 195 Iowa 147, 191 N. W. 803.

<sup>35</sup> *Farmers' Gin and Milling Company v. Jones*, 147 S. W. 668 (Tex. Civ. App.).

<sup>36</sup> *Cook on CORPORATIONS*, 8th ed., sec. 760.

<sup>37</sup> *Weber v. Spokane National Bank*, 64 F. 208. See also *Scherer & Co. v. Everest*, 168 F. 822; *Grand Valley Water Users' Association v. Zumbrunn*, 272 F. 943.

<sup>38</sup> *Junkin v. Plain Dealer Pub. Co.*, 181 Iowa 1203, 165 N. W. 339.

personally liable by statute in some States to third persons for debts in excess of the statutory amount.<sup>39</sup>

In a Nebraska case involving a cooperative the directors executed their accommodation notes therefor in an amount greatly in excess of the indebtedness which the association was authorized to incur under its charter. Ultimately suit was brought against the association, and it was claimed that no recovery could be had because the amount of indebtedness exceeded that allowed by the charter. The court held, however, that the association was liable because the money had been used in the business for the benefit of the association and had not been returned, the court saying, "The right of recovery depends upon the receipt and retention of benefits under or by virtue of the ultra vires contract."<sup>40</sup> An association may be estopped from denying liability for debts created in excess of the amount fixed in its charter.<sup>41</sup>

It appears to be the general rule that, if a corporation exceeds its debt limit, no objection can be raised by either the corporation itself or persons who became its creditors after the debt limit had been reached.<sup>42</sup> In Kentucky, however, when a corporation becomes insolvent, until the creditors whose debts do not exceed the charter limits have been paid in full, creditors whose debts are in excess of the charter limits are not entitled to participate in the distribution of assets.<sup>43</sup> In some jurisdictions, before a contract which would cause a corporation to exceed its debt limit has been performed by either party, it may be repudiated by the corporation.<sup>44</sup>

### Lien on Stock

If a statute under which a corporation is incorporated or the general law of the State gives a corporation a lien on the stock of a stockholder for debts due the corporation by him, strangers, even though without actual notice, and residents of other States, buy the stock subject to the lien. The Supreme Court of the United States has said: <sup>45</sup> "When, by general law, a lien is given to a corporation upon the stock of a stockholder in the corporation for any indebtedness owing by him to it, that lien is valid and enforceable against all the world \* \* \*." If the statute under which an association or corporation is to be incorporated authorizes the inclusion of a provision in the articles of association or the certificate of incorporation giving the corporation a lien on its stock for any indebtedness due it by a stockholder, such a provision, if included, is also valid against all the world.<sup>46</sup>

In a New York case <sup>47</sup> the articles of association provided that—"No shareholder of the association shall be permitted to transfer his shares or receive a dividend or interest thereon, who shall owe to the association a

<sup>39</sup> Annotation "Right of individual creditor to enforce for his own benefit personal liability of directors or officers of corporation for incurring excessive debts," 43 A. L. R. 1147.

<sup>40</sup> *Simmons v. Farmers' Union Coop. Association of Bradshaw*, 114 Neb. 463, 208 N. W. 144.

<sup>41</sup> *New York Canning Crops Coop. Association, Inc., v. Slocum*, 126 Misc. Rep. 30, 212 N. Y. S. 534.

<sup>42</sup> *Sioux City Terminal Railroad & Warehouse Company v. Trust Company of North America*, 82 F. 124, aff'd in 173 U. S. 99, 19 S. Ct. 341, 43 L. Ed. 629; 7 Fletcher CYCLOPEDIA CORPORATIONS, Perm. Ed. sec. 3619.

<sup>43</sup> *First National Bank of Covington v. D. Keefer Milling Company*, 95 Ky. 97, 23 S. W. 675; *American Southern National Bank v. Smith*, 170 Ky. 512, 186 S. W. 482, Ann. Cas. 1918B 959; *Anderson v. Kentucky Title Trust Company of Louisville*, 5 F. Supp. 384.

<sup>44</sup> *Lewis v. Fifth-Third National Bank of Cincinnati*, 274 F. 587.

<sup>45</sup> *Hammond v. Hastings*, 134 U. S. 401, 10 S. Ct. 727, 33 L. Ed. 960.

<sup>46</sup> *Union Bank of Georgetown v. Laird*, 2 Wheat. 390, 4 L. Ed. 269.

<sup>47</sup> *Gibbs v. Long Island Bank*, 83 Hun. 92, 31 N. Y. S. 406, 63 N. Y. St. Rep. 854.



debt which shall have become due, until such debt be paid, unless by and with the consent of the board of directors of the association." On the face of each certificate of stock involved was the statement "Subject to the conditions and stipulations contained in the articles of association." Although the plaintiff had no actual knowledge of the limitation on the transfer of stock, he was held bound by the provision in the articles of association.

At least in some States if the purchaser or assignee of stock has actual or constructive notice of a bylaw giving the corporation a lien on the stock, it is effective, and the corporation is not obliged to recognize the purchaser or assignee of the stock unless the lien is given effect.<sup>48</sup>

## Subscriber, Stock, Capital Stock

"A subscriber is one who has agreed to take stock from the corporation on the original issue of such stock."<sup>49</sup> The shares of stock into which the capital stock of the corporation is divided may consist of common stock or common and preferred stock. In Cook on Corporations it is also said:<sup>50</sup>

By *common stock* is meant that stock which entitles the owners of it to an equal pro rata division of profits, if any there be; one stockholder or class of stockholders having no advantage, priority or preference over any other shareholder or class of stockholders in the division. By *preferred stock* is meant stock which entitles its owners to dividends out of the net profits before or in preference to the holders of the common stock. Common stock entitles the owner to pro rata dividends equally with all other holders of the stock except preferred stockholders; while preferred stock entitles the owner to a priority in dividends.

Usually the dividend rate on preferred stock is fixed, whereas that on common stock in commercial corporations is generally not fixed.

Under the statutes of many States the right to vote at meetings of the stockholders is limited to the common stockholders, and many of the statutes providing for incorporation of cooperatives authorize bylaws that limit the right to vote to common stockholders of the corporation.

\* \* \* the capital stock is usually divided into equal portions called shares; and a share of the capital stock of a corporation is, therefore, the interest or right which the owner has in the management of the corporation, in its surplus profits, and upon dissolution, in all of its assets remaining after the payment of its debts.<sup>51</sup>

Shares of stock usually are represented by certificates. A certificate of stock is not the stock itself but simply evidence of its ownership, just as a deed is evidence of the ownership of land. A stockholder or shareholder is one who owns one or more shares of stock. One may be a stockholder, although no certificate of stock has been issued to him,<sup>52</sup> just as one may be the owner of other personal property, although he has never received a bill of sale thereto.

A stockholder is not by reason of this fact a creditor of an association, and the possession of a certificate of stock, whether common or preferred, represents not indebtedness but ownership.<sup>53</sup>

<sup>48</sup> *Iowa-Missouri Grain Co. v. Powers*, 198 Iowa 208, 196 N. W. 979, 33 A. L. R. 1268. For a discussion of the question of priority between the lien of the corporation and the rights of a pledgee or bona fide purchaser of corporate stock, see the Annotation in 81 A. L. R. 989.

<sup>49</sup> 1 COOK ON CORPORATIONS, 8th ed., sec. 10, p. 51.

<sup>50</sup> 1 COOK ON CORPORATIONS, 8th ed., sec. 12, p. 76.

<sup>51</sup> 14 C. J. 384.

<sup>52</sup> *In re Culver's Estate*, 145 Iowa 1, 123 N. W. 743, 25 L. R. A. (N. S.) 384; *Bushnell v. Elkins*, 34 Wyo. 495, 245 P. 304, 51 A. L. R. 13.

<sup>53</sup> *Sternbergh v. Brock*, 225 Pa. 279, 74 A. 166, 24 L. R. A. (N. S.) 1078; *Wineinger v. Farmers' & Stockmen's Loan & Investment Association*, 278 S. W. 932 (Tex. Civ. App.), affirmed, 287 S. W. 1091 (Tex. Com. App.).

However, when a provision of a certificate of preferred stock absolutely obligated a corporation to pay the par value thereof on a certain date with cumulative dividends, it was held that the holder of the certificate was a creditor and that his rights should be determined accordingly.<sup>54</sup>

An overissue of stock by an association is void.<sup>55</sup> Apparently the association would at least be liable for the purchase price of the over-issued stock.<sup>56</sup>

When the constitution of a State imposes double liability on stockholders, a stockholder is not subject to such double liability on stock which the corporation was not authorized to issue.<sup>57</sup>

Stock may be assigned or transferred only by those who are authorized to do so. A warehouse corporation issued stock to growers of tobacco who were members of a tobacco marketing association. The stock was paid for through deductions made by the association from the proceeds derived from the sale of tobacco. The certificates of stock were retained by the warehouse corporation. Later the association claimed that the growers were indebted to it for liquidated damages for breach of their marketing agreements. The warehouse corporation thereupon canceled the certificates of stock issued in favor of the growers and issued new certificates of stock in favor of the marketing association. It was held, however, that as the growers had not authorized the transfer or assignment of their certificates of stock and as the marketing association and the warehouse corporation were not authorized to determine and adjust the claims of the association against the growers, the marketing association was not entitled to receive any part of the liquidating dividends declared by the warehouse corporation on the stock. It was further held that the warehouse corporation was not estopped from showing that the issuance of the stock to the marketing association was without authority.<sup>58</sup>

It is not always indispensable that a person sign a subscription for stock to hold him as a subscriber; and where a stockholder attended a meeting of stockholders at which he voted in favor of organizing a new corporation for the purpose of taking over the stock of the old corporation, it was held that such a stockholder who signed the articles of incorporation of the new company should be deemed to have subscribed for the amount of stock which he held in the old.<sup>59</sup>

Where a person subscribed for stock of a cooperative on condition that the subscription would be "used to do business on the Rochdale System," failure to so operate was held to be no defense to a suit on the subscription, as the corporation had incurred debts on the strength of the subscription and as it would have enhanced "the burden of those stockholders who had paid in full." Neither did a previous refusal to accept the amount of his subscription release him "as against creditors or other stockholders."<sup>60</sup>

<sup>54</sup> *Oklahoma Wheat Pool Elevator Corporation v. Bouquot*, 180 Okla. 159, 68 P. 2d 97. See also 14 C. J. 416; *O'Brien Mercantile Company v. Bay Lake Fruit Growers' Association*, 178 Minn. 179, 226 N. W. 513.

<sup>55</sup> *Graf v. Neith Cooperative Dairy Products Association*, 216 Wis. 519, 257 N. W. 618; *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; 1 Cook on CORPORATIONS, 8th ed., sec. 292.

<sup>56</sup> 1 Cook on CORPORATIONS, 8th ed., sec. 293.

<sup>57</sup> *Maclaren, as Receiver of Goodhue County Cooperative Company v. Wold*, 168 Minn. 234, 210 N. W. 29, 55 A. L. R. 321, 172 Minn. 334, 215 N. W. 428.

<sup>58</sup> *Burley Tobacco Growers' Coop. Association v. Indiana District Warehousing Corporation*, 102 Ind. App. 138, 199 N. E. 436.

<sup>59</sup> *Zander v. Schuneman*, 170 Minn. 353, 212 N. W. 587. But see *Jackson v. Sabie*, 36 N. D. 49, 161 N. W. 722.

<sup>60</sup> *Warren Company Cooperative Association v. Boyd*, 171 N. C. 184, 88 S. E. 153. See also *Equity Cooperative Association of Roy v. Equity Cooperative Milling Company of Montana*, 63 Mont. 26, 206 P. 349; 14 C. J. 512.

A subscriber for stock in Nebraska, when sued on the promissory note which he gave therefor, successfully defended by showing that he was induced to buy stock by representations that within a year "a new \$40,000 elevator would be built to take the place of the old one which was dilapidated and out of date"; and that the new structure would be equipped with modern machinery and that he "and other subscribing patrons, would be paid 2 or 3 cents a bushel above local market prices for grain at the new elevator; that the stock would 'carry itself' and that defendant would never be called upon to pay the note except from dividends on his stock which would be derived from increased earnings \* \* \*." <sup>61</sup>

In the absence of statutory requirements, contracts for the sale or purchase of shares of stock in a fully organized corporation are made in the same manner as other contracts and are governed by like principles. <sup>62</sup>

It has been held that, if a person in subscribing for stock relies on false representations that others in whom he has confidence have already subscribed, this constitutes a fraud justifying a rescission of the subscription contract, if such action is taken "promptly and before the rights of creditors have intervened." <sup>63</sup>

Where an association began business without having all its capital stock subscribed, as required by statute, it was held that a subscriber for stock was not liable, on account of this fact, on his stock subscription and that the corporation was not entitled to apply the purchase price of milk delivered by the subscriber on the payment of his note given for the purchase of stock. <sup>64</sup>

Even though the bylaws of a cooperative provide for the repurchase of its stock, if the matter is discretionary with the association, a stockholder is not entitled, without the consent of the association, to have his stock retired or to have its value used as an offset to a claim which the association has against him, <sup>65</sup> nor under any circumstances is a stockholder entitled to have his stock retired unless all conditions precedent to doing so have been met. <sup>66</sup> Where the State statute authorizes the cooperative to repurchase its stock at its par value when the shareholder ceases to be eligible, the shareholder cannot require payment in excess of par. <sup>67</sup>

When stock or memberships in an association are repurchased for less than their liquidating value, at least from a liquidating standpoint the remaining members are benefited. <sup>68</sup>

The stock subscription form employed by cooperatives usually contains, in addition to an agreement to purchase a stated number of shares of stock upon the happening of a specific contingency, an agreement to market certain commodities of the subscriber through the association, when organized. If the subscription is invalid by reason of the fact that conditions

<sup>61</sup> *Farmers' Cooperative Grain Company v. Startzer*, 112 Neb. 19, 198 N. W. 170. See also *Divine v. Western Slope Fruit Growers' Association*, 27 Colo. App. 368, 149 P. 841.

<sup>62</sup> *Equity Cooperative Association of Roy v. Equity Cooperative Milling Company of Montana*, 63 Mont. 26, 206 P. 349; 14 C. J. 512.

<sup>63</sup> *Bohn v. Burton-Lingo Company*, 175 S. W. 173 (Tex. Civ. App.); *Webb v. Tri-State Fair & Racing Association*, 238 Ky. 87, 36 S. W. 2d 839. See also *Vest v. Farmers Cooperative Elevator Co. of Riverdale*, 108 Neb. 407, 187 N. W. 892.

<sup>64</sup> *Flury v. Twin Cities Dairy Company*, 136 Wash. 462, 240 P. 900.

<sup>65</sup> *Lewiston Coop. Soc. No. 1 v. Thorpe*, 91 Me. 64, 39 A. 283. But cf. *Farmers Union Coop. Gin Co. v. Taylor*, 197 Okla. 495, 172 P. 2d 775.

<sup>66</sup> *Fillmore v. Farmers' Union Coop. Association*, 139 Okla. 38, 280 P. 1072. See also Bylaws, p. 33.

<sup>67</sup> *Avon Gin Co. v. Bond*, 198 Miss. 197, 22 So. 2d 362.

<sup>68</sup> *Keeler v. New York Hide Exchange*, 231 App. Div. 450, 247 N. Y. S. 482.



precedent to organization have not been complied with, the question arises whether the association will be able to enforce its marketing agreement, as well as whether it will be able to hold the subscriber for his subscription to capital stock. Cases involving the right of an association to enforce its marketing agreements because of some defect in the organization procedure are considered elsewhere.<sup>69</sup>

### How Stock Is Paid For

Stock, as a rule, may be paid for with cash, other property, or labor. In most States there are statutory provisions relative to paying for stock otherwise than with cash, and these should be ascertained and carefully followed. In some States the cooperative statutes provide substantially as follows:

No association shall issue stock to a member until it has been fully paid for. The promissory notes of the members may be accepted by the association as full or partial payment. The association shall hold the stock as security for the payment of the note; but such retention as security shall not affect the member's right to vote.<sup>70</sup>

In the absence of charter or statutory provisions, stock may be issued in payment for property, but the property should be worth the par value of the stock received for it. It is the general rule that for a payment for stock to be good against the corporation or creditors thereof, it must be paid for in money or what may fairly be considered the equivalent of the money value.<sup>71</sup>

### Stock and Nonstock Associations

A stock corporation is a corporation that has capital stock. As evidence of these shares certificates of stock are usually issued. The owners of these certificates of stock, by acquiring them, become the shareholders or stockholders, and thus become the "owners" of the corporation.

Capital stock and stock certificates are generally regarded as characteristics of a business corporation. That is, business corporations usually have capital stock and usually issue certificates of stock. This is not necessarily true. For corporations are creations of the legislature and it can, within constitutional limitations, endow them with such powers and limitations as seem advisable. The State, then, can create business corporations without the elements mentioned. This is not generally done, but the power to do so undoubtedly exists. In short, the legislature has complete control, within constitutional limitations, of the creation of corporations. It may make no provision for their creation, or it may grant to those created closely limited or very wide powers.

Nonstock corporations do not have capital stock and, aside from agricultural and other cooperatives, usually are not commercial organizations. They generally issue to their members certificates of membership evidencing the right of the members in the corporation. Some of the more common types of corporations of this class are incorporated churches, clubs, or social organizations.

In the early history of business corporations having capital stock, certificates of stock evidencing the shares into which the capital stock of the corporation has been divided were not issued, but as time went on some corporations issued certificates of stock evidencing the interest of shareholders in the corporation.

<sup>69</sup> See When Marketing Contracts Become Effective, p. 99.

<sup>70</sup> See sec. 14 of Bingham Cooperative Marketing Act of Kentucky, p. 304 of Appendix.

<sup>71</sup> *In re Manufacturers' Box & Lumber Co.*, 251 F. 957.

The convenience and desirability of stock certificates which could be readily transferred from hand to hand were so apparent that it soon came to be looked upon as a right of a member of a business corporation to have certificates of stock issued to him. And now purchasers of stock may generally require the corporation to issue certificates of stock.<sup>72</sup>

From an early date stock certificates were assigned and transferred; and this assignability is generally regarded as one of their leading qualities. In general, the policy of the law is opposed to restraint on the disposition or sale of property. The courts, however, have upheld restrictions on the right of members to transfer shares of stock. At common law, shares of stock are regarded as personal property capable of sale, transfer, or succession in any of the ways by which personal property may be transferred.<sup>73</sup>

On the other hand, the interest which a member has in a nonstock corporation, which is usually evidenced by a certificate of membership, is not transferable at common law. In a certain case the plaintiff acquired a certificate of membership from one who was formerly a member of a nonstock corporation, but it was held that this did not constitute the plaintiff a member of the corporation.<sup>74</sup> Certificates of membership may be made transferable by statute, by charter, or by authorized bylaws, but in the absence of specific provisions on the subject they are not transferable. Fundamentally, therefore, certificates of membership are not transferable, whereas shares of stock fundamentally are transferable.

Churches were among the first organizations to be incorporated. It is obvious that church membership, from its peculiar personal quality, is essentially nontransferable. This personal element, which is so apparent in the case of church organizations and in social clubs and kindred organizations, may have been responsible for the establishment of the concept, both in the decisions of the courts and in the minds of the people, that membership in a nonstock corporation is not assignable. This principle is basic, and in the absence of special provision on the subject, is applicable. In view of the foregoing, it is apparent that fundamentally a nonstock association can control its membership better than can a stock association.

At common law the stock of a member of a corporation cannot be forfeited and the member expelled from the corporation, whereas nonstock corporations possess the inherent right to expel members for cause.<sup>75</sup> This right was recognized from an early date as one of the inherent powers of a nonstock corporation. Without any charter or statutory provisions on the subject, a nonstock corporation may for cause expel members, but this is not true with respect to a stock corporation. If the charter of a nonstock corporation is silent on the power of expulsion and there are no statutory provisions on the subject, the decided weight of authority is that a member may be expelled for only three reasons: (1) Offenses of an infamous nature indictable at common law; (2) offenses against the member's duty to the corporation; (3) offenses compounded of the two.<sup>76</sup> Unless otherwise provided by law, the right of expulsion is in the membership.<sup>77</sup>

<sup>72</sup> *Mutual Telephone Co. v. Jarrell*, 220 Ky. 551, 295 S. W. 865.

<sup>73</sup> 2 Cook on CORPORATIONS, 8th ed., sec. 331; *Mobile Mut. Ins. Co. v. Cullom*, 49 Ala. 558; *Boston Music Hall v. Cory*, 129 Mass. 435.

<sup>74</sup> *American Live-Stock Commission Co. v. Chicago Live-Stock Exchange*, 143 Ill. 210, 32 N. E. 274, 18 L. R. A. 190, 36 Ann. St. Rep. 385.

<sup>75</sup> 8 FLETCHER CYCLOPEDIA CORPORATIONS, Perm. Ed., sec. 5696.

<sup>76</sup> *State ex rel. Graham v. Chamber of Commerce*, 20 Wis. 68.

<sup>77</sup> *State ex rel. Boldt v. St. Cloud Milk Producers' Association*, 200 Minn. 1, 273 N. W. 603.

In the absence of restrictions in the charter, contracts, or bylaws of a nonstock corporation or of a statutory provision on the subject, a member may withdraw at any time, and no acceptance is required.<sup>78</sup> On the other hand, shareholders of a corporation having capital stock cannot, strictly speaking, withdraw from the corporation.<sup>79</sup>

This brief sketch on the differences between stock and nonstock corporations explains why a stock corporation is generally thought of as a commercial organization; that is, as an organization in which money, rather than the personnel of the membership, is the dominant factor. By appropriate charter or statutory provisions a stock corporation may exercise control over its membership resembling that exercised by nonstock corporations. Indeed, no reason is apparent why the legislature could not endow stock corporations, at least at the time of their creation, with as complete control over their membership as that possessed by nonstock corporations. In many jurisdictions at this time statutes providing for the incorporation of cooperatives with capital stock exist which authorize charter and bylaw provisions conferring on associations control over their stockholders comparable with that fundamentally possessed by nonstock corporations.

Frequently the phrase "nonprofit, nonstock" is used with reference to an association, as though the organization would be one for profit if it were formed with capital stock. This is a mistake. An association is not nonprofit because it is formed without capital stock, but because of the manner in which it operates. In other words, an association formed with capital stock may operate on a nonprofit basis just as well as an association formed without capital stock. An association must have capital, and if it is not raised through the sale of stock it must be obtained in some other way. Indeed capital stock is frequently sold at a price comparable with that ordinarily paid for a certificate of membership in a nonstock association; so that it would be possible in theory to raise as much money through the sale of certificates of membership as it would be through the sale of stock certificates. It is the way that an association operates that determines whether it is a profit-making institution rather than whether it is formed with or without capital stock.

It has been said "that the members of a nonstock cooperative stand in substantially the same relation to the corporation as do the members of a cooperative with capital stock or other business corporation with capital stock."<sup>80</sup> However, this should not be construed to mean that the terms "member" and "stockholder" are synonymous.

In many of the agricultural association acts, the term "member" is defined so as to include common stockholders in associations formed with stock and the members of nonstock associations. This has led to some confusion.

For example, in a case involving the question as to whether the board of directors of an electric cooperative organized on a membership basis without capital stock had been duly authorized to borrow under the Rural Electrification Act, the chairman of the meeting ruled that the resolution had not passed. This ruling was based on a section of the Kentucky statute which required approval by a "majority of the common stockholders." The chairman apparently had overlooked other provisions of the statute which permitted action by a majority of the members present and voting at the meet-

<sup>78</sup> *Ewald v. Medical Society*, 130 N. Y. S. 1024, 70 Misc. 615, reversed on other grounds, 128 N. Y. S. 886, 144 App. Div. 82; *Finch v. Oake*, 73 L. T. R. (n. s.) 716.

<sup>79</sup> *Picalora v. Gulf Cooperative Co.*, 123 N. Y. S. 980, 68 Misc. Rep. 331.

<sup>80</sup> *State ex rel. Boldt v. St. Cloud Milk Producers' Association*, 200 Minn. 1, 273 N. W. 603, 607.



ing in membership corporations. The Supreme Court of Kentucky, after examining the Rural Electrification Act of Kentucky, reached the conclusion that the statutory provision which required obligations of a cooperative to be authorized by a majority of the common stockholders had no application to a nonstock cooperative, and that an obligation of the nonstock electric cooperative was sufficient when authorized by a majority of a quorum of the members, although this was less than a majority of the members.<sup>81</sup>

## Restrictions as to Transfer of Stock

May an incorporated cooperative or any other corporation restrict the transfer of its stock so as to prevent its being held by nonproducers? The answer is "Yes," if appropriate statutory authority exists in the State in which the association is incorporated. Many of the statutes providing for the incorporation of cooperatives contain provisions restricting the issuance of common stock, or its transfer to nonproducers. Associations formed under statutes that contain such provisions are thereby prohibited from issuing common stock to nonproducers, and in the event of a member's attempting to transfer his stock to a nonproducer, the association could refuse to recognize the transfer.

The courts have recognized the importance of allowing a cooperative to restrict the transfer of its stock so as to prevent its purchase by those who would be antagonistic to it, and thereby defeat the purpose for which the association was formed.<sup>82</sup>

In the North Dakota case just cited the court said:

If stock in cooperative corporations could be sold and transferred the same as corporate stock in ordinary business corporations, to any person whom the stockholder saw fit, then it would be possible for persons whose interests were antagonistic to the cooperative association to become members therein, and thereby defeat the very purpose for which the corporation was formed. So it seems not only proper, but necessary, in order that such corporations may continue and accomplish the purpose for which they are organized, to permit restrictions to be placed upon the right to transfer and own stock therein.

If a statute of the State expressly restricts the transfer of stock except under certain conditions, the matter is clear. This was the situation in a Minnesota case<sup>83</sup> where the statute under which the association was incorporated provided that "no person shall be allowed to become a shareholder in such association except by the consent of the managers of the same." The court said: "We have no doubt of the validity of such a restriction on the transfer of shares." If the statute of the State under which the association is incorporated authorizes the inclusion of a provision in the articles of association or the certificate of incorporation, or the bylaws, restricting the transfer of stock, there would seem to be no doubt concerning the right of an association to adopt such a restriction and it would be binding on innocent third persons, as one is charged by law with notice of the law under which an association is formed and of what it permits.<sup>84</sup>

<sup>81</sup> *Warren Electric Cooperative Corporation, Inc. v. Harrison*, 312 Ky. 702, 229 S. W. 2d 473. Cf. *Autauga Cooperative Leasing Association v. Ward*, 250 Ala. 229, 33 So. 2d 904.

<sup>82</sup> *Chaffee v. Farmers' Coop. Elevator Co.*, 39 N. D. 585, 168 N. W. 616, 618; *Carpenter v. Dummit* [Burley Tobacco Growers' Cooperative Association], 221 Ky. 67, 297 S. W. 695; *Farmers Union Coop. Gin Co. v. Taylor*, 197 Okla. 495, 172 P. 2d 775; *Thomason v. Clark County Farm Bureau Tobacco Cooperative, Inc.*, 259 S. W. 2d 64 (Ky.).

<sup>83</sup> *Healey v. Steele Center Creamery Association*, 115 Minn. 451, 133 N. W. 69, 72.

<sup>84</sup> *Longyear v. Hardman*, 219 Mass. 405, 106 N. E. 1012, Ann. Cas. 1916D 1200; *Casper v. Kalt-Zimmers Mfg. Co.*, 159 Wis. 517, 149 N. W. 754.

It has been held that when the charter of a cooperative, in pursuance of statutory authority therefor, limits eligibility to own its common stock to producers, a pledgee of such stock is charged by law with notice of such restrictions, and even as against such a pledgee the association may cancel the stock on account of indebtedness due by the stockholder to the association.<sup>85</sup>

From the cases that have come before the courts it is apparent that the required statutory authority need not expressly authorize restrictions on the transfer of stock, but general language dealing with this subject would seem to be enough. A few illustrations from decided cases will shed light on this matter. In a New York case the certificates of incorporation of each of the three corporations involved, "\* \* \* provided that no stock should be transferred until it was first offered for sale to the other stockholders on terms and conditions to be fixed by the bylaws or by an agreement between the stockholders, but, in case the offer to sell were refused, the stock would be no longer subject to the conditions." The court held this provision and the bylaws and the agreement connected therewith valid and enforceable. Notice of the restrictions on the sale of stock was stamped on each certificate of stock.<sup>86</sup> Section 13 of the General Corporation law of New York provides that "The certificate of incorporation of any corporation may contain any provision for the regulation of business and the conduct of its affairs, and any limitation upon its powers, or upon the rights of its stockholders or upon the powers of its directors and members, which does not exempt them from the performance of any obligation or duty imposed by law." It was apparently in pursuance of this provision that the restrictions on the right to transfer the stock were included in the certificates of incorporation.

A statute may authorize associations incorporated under it to adopt bylaws restrictive of the right to transfer stock. This was the situation in a North Dakota case.<sup>87</sup> The statute empowered associations incorporated under it "to regulate and limit the right of stockholders to transfer their stock" and "to make bylaws for the management of its affairs, and to provide therein the terms and limitations of stock ownership." It was held that a bylaw which provided that "No stockholder shall transfer his stock without first giving the corporation 90 days' notice and option to purchase said stock at par, plus the accrued and undivided dividends, which are payable per share \* \* \*" was valid. The bylaw was referred to on the face of the certificates of stock.

A similar conclusion was reached in an Ohio case involving an analogous statutory provision.<sup>88</sup> If the statute under which an association is incorporated authorizes the inclusion in the articles of association or the certificate of incorporation, or in the bylaws, of a provision restricting the transfer of its stock, such a provision will be enforced by the courts of the State where suit is brought, although the association was incorporated in another State. These were the facts in the case last mentioned. In that case the corporation was incorporated in Delaware, but the transactions relative to the stock took place in Ohio, where the corporation had its principal place of business, and the suit was brought there.

<sup>85</sup> *Stuttgart Cooperative Buyers Association v. Louisiana Oil Refining Corporation*, 194 Ark. 779, 109 S. W. 2d 682. See also *Mayse v. Mineola Cooperative Exchange*, 139 Kan. 24, 30 P. 2d 120.

<sup>86</sup> *Bloomington v. Bloomington*, 177 N. Y. S. 873, 874, 107 Misc. Rep. 646. Compare, *Evans v. Dennis*, 203 Ga. 232, 46 S. E. 2d 122.

<sup>87</sup> *Chaffee v. Farmers' Coop. Elevator Co.*, 39 N. D. 585, 168 N. W. 616.

<sup>88</sup> *Nicholson v. Franklin Brewing Co.*, 82 Ohio St. 94, 91 N. E. 991, 137 Am. St. Rep. 764, 19 Ann. Cas. 699.

A Kentucky case involved a subsidiary warehouse corporation of the Burley Tobacco Growers' Cooperative Association. Although there was no authority in the general corporation laws of the State under which the warehouse corporation was formed that authorized the language included in its articles of incorporation and bylaws to the effect that the common stock should be sold and issued only to members of the association, the court was of the opinion that the public policy of the State favored such restrictions in the case of cooperatives because the cooperative statute authorized them. Therefore the court held that the warehouse corporation was not required to issue common stock to a party not a member of the association who had taken an assignment in good faith from one of its members, but held that the assignee was entitled to a lien on the stock in the hands of the association.<sup>89</sup>

All courts hold that reasonable restrictions on the transfer of stock are valid if statutory authority therefor exists, but if no statutory authority exists the courts are not in harmony regarding the validity of such restrictions. In the absence of statutory or charter provisions providing otherwise, notice given on the face of a certificate of stock that it may be transferred only under certain conditions, or to members of a specified class, would appear to be sufficient in some States to prevent a prospective purchaser from acquiring title thereto, even though no statutory authority existed for the restriction.<sup>90</sup>

The importance of having restrictions on the transfer of stock appear on the face of stock certificates is emphasized by the fact that the Uniform Stock Transfer Act, as enacted in many of the States, provides that—

There shall be no lien in favor of such corporation upon the shares represented by a certificate issued by such corporation and there shall be no restriction upon the transfer of shares so represented by virtue of any by-law, of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.<sup>91</sup>

Even though a bylaw restricting the right to transfer stock is unauthorized by the statute under which the corporation is formed, such bylaws have been enforced in some States as contracts between the corporation and its members.<sup>92</sup> In other States, however, a contrary conclusion has been reached.<sup>93</sup>

Closely akin to the question whether a cooperative may restrict the transfer of its stock is the right of such an association to purchase its stock from its members. Many of the statutes providing for the formation of cooperatives contain provisions authorizing the associations to purchase or redeem their stock. If such provisions appear in the statute under which an association is formed, it is clear that it has the right to do so, assuming that the constitution of the State does not contain a provision to the contrary.

Even though no statutory authority for the purchase or redemption of stock is contained in the statute under which the association is formed,

<sup>89</sup> *Carpenter v. Dummit* [Burley Tobacco Growers' Cooperative Association], 221 Ky. 67, 297 S. W. 695.

<sup>90</sup> *Wilkinson v. Home Bank*, 137 Tenn. 198, 192 S. W. 920; *Jewell v. Nuhn*, 173 Iowa 112, 155 N. W. 174, Ann. Cas. 1918D 356.

<sup>91</sup> See *United States Gypsum Company v. Houston*, 239 Mich. 249, 214 N. W. 197, 198.

<sup>92</sup> *Lewis v. H. P. Hood & Sons, Inc.*, 331 Mass. 670, 121 N. E. 2d 850; *New England Trust Co. v. Abbott, Ex'r*, 162 Mass. 148, 38 N. E. 432, 27 L. R. A. 271; *Model Clothing House v. Dickinson*, 146 Minn. 367, 178 N. W. 957.

<sup>93</sup> *Steele v. Farmers' & Merchants' Mutual Tel. Association*, 95 Kan. 580, 148 P. 661; *Brinkerhoff-Farris Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447, 24 S. W. 129.



ordinarily it would have the right to do either because at common law a corporation, by the weight of authority, may purchase its own stock if solvent and if no injury to creditors results.<sup>94</sup>

It is illegal in some States for corporations to buy their own stock.<sup>95</sup>

### Who May Become Members

May a cooperative select its members and thus determine for whom it will market products or furnish supplies? Judging by the decisions of the courts with respect to other organizations the answer is "Yes." In the absence of a statute prescribing rules relative to the admission of members or stockholders, an association at common law is free to accept some and reject others. With respect to nonstock associations, numerous court decisions support this view.<sup>96</sup> The Supreme Court of Minnesota has held that the right to membership in a corporation might, by a provision in its articles of incorporation, be restricted to persons of a certain nationality where the provision was not inconsistent with any statute.<sup>97</sup>

The courts have universally declared that stock corporations have the right to determine to whom they will sell their stock.<sup>98</sup> The right of associations to restrict the transfer of their stock is discussed in the section on Restrictions as to Transfer of Stock, page 48.

Membership in a nonstock association or a certificate of membership evidencing the same is not transferable<sup>99</sup> in the absence of a statutory, charter, or bylaw provision making it transferable.

A rural electric association declined to admit certain farmers as members and it was apparently accepted that the association was acting within its legal rights.<sup>1</sup> In another case involving a similar cooperative the court held that membership "was not a matter of right."<sup>2</sup>

An applicant for membership is not entitled to the rights of membership until he has fulfilled all the prerequisites therefor. Thus, in a case in which applicants were required to make payment in full for stock at the beginning of the season, the association had a right to deny patronage dividends to those who had failed to do so.<sup>3</sup>

<sup>94</sup> *Whitney v. Farmers' Coop. Grain Co.*, 110 Neb. 157, 193 N. W. 103; *Cole v. Cole Realty Co.*, 169 Mich. 347, 135 N. W. 329.

<sup>95</sup> *Poultry Producers of Southern California, Inc. v. Barlow*, 189 Cal. 278, 208 P. 93; *Poultry Producers of Central California, Inc. v. Murphy*, 64 Cal. App. 450, 221 P. 962.

<sup>96</sup> *McKane v. Adams as President of the Democratic General Committee of Kings Co.*, 123 N. Y. 609, 25 N. E. 1057, 20 Am. St. Rep. 785; *Connelly v. Masonic Mutual Benefit Association*, 58 Conn. 552, 20 A. 671, 9 L. R. A. 428, 18 Am. St. Rep. 296; *State v. Sibley*, 25 Minn. 387; *LaSalle County Farm Bureau v. Thompson*, 245 Ill. App. 413; *Press & Co. v. Fahy*, 313 Ill. 262, 145 N. E. 103; 6 R. C. L., par. 371; 25 R. C. L. 54; *Gold Knob Outdoor Advertising Co. v. Outdoor Advertising Association of Texas*, 225 S. W. 2d 645 (Tex. Civ. App.). But cf. *Porterfield v. Black Bill & Doney Parks Water Users' Association*, 69 Ariz. 110, 210 P. 2d 335.

<sup>97</sup> *Blein v. Rand*, 77 Minn. 110, 79 N. W. 606, 46 L. R. A. 618. See also *Mills, D. N. Labor Law—right of union to deny membership to applicant*. 40 Mich. L. Rev. 2-310 (1941).

<sup>98</sup> 14 C. J. 838.

<sup>99</sup> *American Live-Stock Commission Co. v. Chicago Live-Stock Exchange*, 143 Ill. 210, 32 N. E. 274, 18 L. R. A. 190, 36 Am. St. Rep. 385.

<sup>1</sup> *Bailey v. Carolina Power & Light Company*, 212 N. C. 768, 195 S. E. 64.

<sup>2</sup> *Ford v. Peninsula Light Company*, 164 Wash. 599, 4 P. 2d 504; but see *Alabama Power Co. v. Cullman County Electric Membership Corporation*, 234 Ala. 396, 174 So. 866.

<sup>3</sup> *Farmers Truck Association v. Strawberry & Vegetable Auction, Inc.*, 163 So. 181 (La. App.).

When a marketing agreement was signed by two parties "as joint tenants" it was held that they were members of the association and that the contract was enforceable against them.<sup>4</sup>

With respect to the general subject under discussion, it should be remembered that those engaged in a private business at common law may arbitrarily refuse to sell to or buy from others.<sup>5</sup> Banks, according to common law, may arbitrarily select their depositors;<sup>6</sup> and even a doctor, although the only one available, in the absence of a statute requiring him to serve all who come, has the right to determine arbitrarily with whom he will have dealings.<sup>7</sup>

A cooperative, also, can adopt rules or bylaws to be followed in determining whether a person is eligible to be admitted to membership. For instance, an association can adopt a bylaw to the effect that only producers who are members of some other organization may buy stock or be admitted to membership.<sup>8</sup>

### Membership—How Acquired

There is nothing mysterious about becoming a member of a cooperative. The basic principles are similar to those applicable to becoming a member of any other corporation. Generally speaking, an association may choose whom it will admit to membership.<sup>9</sup> That is, an association, whether formed with or without stock, is free to determine the qualifications one must possess to be eligible for membership. Cooperative statutes usually specifically authorize the adoption of bylaws covering these matters.<sup>10</sup> Bylaws of associations frequently provide that, before applications for membership or subscriptions for stock may be accepted, the applicants or subscribers must first be approved by the board of directors or must meet conditions prescribed by the board. Fundamentally, no person may become a member of an association formed with capital stock without acquiring at least one share thereof.<sup>11</sup> Many of the cooperative acts prescribe that the holders of common stock shall be members of associations. At common law, however, a stockholder is regarded as a member regardless of the character of the stock held by him.

In a nonstock association there must be an application for membership and an acceptance thereof, or an offer of membership and an acceptance of such an offer.<sup>12</sup>

In a California case <sup>13</sup> it was said that—

A careful search of the record fails to disclose any proof that the plaintiff ever accepted the defendant as a member \* \* \*.

<sup>4</sup> *Lennox v. Texas Cotton Coop. Association*, 55 S. W. 2d 543 (Tex. Com. App.).

<sup>5</sup> *Federal Trade Commission v. Raymond Brothers-Clark Co.*, 263 U. S. 565, 44 S. Ct. 162, 68 L. Ed. 448, 30 A. L. R. 1114.

<sup>6</sup> *Elliott v. Capital City State Bank*, 128 Iowa 275, 103 N. W. 777, 111 Am. St. Rep. 198, 1 L. R. A. (N. S.) 1130.

<sup>7</sup> *Hurley v. Eddingfield*, 156 Ind. 416, 59 N. E. 1058, 83 Am. St. Rep. 198.

<sup>8</sup> *Connolly v. Masonic Mutual Benefit Association*, 58 Conn. 552, 20 A. 671, 9 L. R. A. 428, 18 Am. St. Rep. 296; *Carpenter v. Dummit* [*Burley Tobacco Growers' Cooperative Association*], 221 Ky. 67, 297 S. W. 695.

<sup>9</sup> See *Who May Become Members*, p. 51.

<sup>10</sup> See sec. 7 of Bingham Cooperative Marketing Act of Kentucky, p. 302 of Appendix.

<sup>11</sup> *Producers Livestock Marketing Association of Salt Lake City*, 45 B. T. A. 325; 13 Am. Jur., p. 455, sec. 398; see *Subscriber, Stock, Capital Stock*, p. 42.

<sup>12</sup> *Johanson v. Riverside County Select Groves, Inc.*, 4 Cal. App. 2d 114, 40 P. 2d 530.

<sup>13</sup> *Sun-Maid Raisin Growers of California v. K. Arakelian, Inc.*, 90 Cal. App. 10, 265 P. 832. See also *Ellis v. Journeyman Barbers' International Union of America*, 194 Iowa 1179, 191 N. W. 111, 32 A. L. R. 756.

It should be clear that membership is the result of a contractual undertaking.<sup>14</sup> A contract requires a meeting of minds and affirmative action by each of the parties thereto. Sometimes associations have attempted to make persons members by including in their bylaws provisions that those who consign to or otherwise transact business with them thereby become members. Inasmuch as nonmembers of an association who patronize it are ordinarily unaware of such provisions in the bylaws, these provisions do not automatically operate to make nonmember patrons members. Such provisions in bylaws may be construed as offers of membership, but there must be informed action on the part of patrons before membership, as a matter of law, results.

In some instances associations have placed upon the form of check or draft given to patrons on account of commodities purchased of them statements to the effect that endorsement constitutes an application for membership in the association.

In at least two States, Arkansas<sup>15</sup> and South Carolina,<sup>16</sup> penal statutes have been enacted to the effect that the endorsement by a person of a "draft or check containing conditions which purport to make a person a member of a cotton cooperative association as a prerequisite to obtaining money on any draft or check given to him for any cotton which he has sold or pledged to any cotton cooperative association shall not be construed as making such person a member of the association." Such statutes further provide that membership may be obtained only by the execution of a membership contract in duplicate.

It has been held that the purchasers of debentures of an association did not by reason of that fact alone become stockholders thereof.<sup>17</sup>

If marketing agreements are to be assigned by one association to another, provision for doing so should be made in the marketing agreement and procedure should be prescribed under which producers whose marketing agreements are assigned may be made members of the second association.<sup>18</sup>

## Rights of Members

In a practical and nonlegal sense the members are the association. Members have the right (1) to choose and to remove the directors of an association;<sup>19</sup> (2) to adopt or change its bylaws;<sup>20</sup> (3) to require the officers and directors (agents) to keep within the limits of law, the association's charter, its bylaws, and its marketing contracts;<sup>21</sup> (4) to hold the officers

<sup>14</sup> *Constructors' Association of Western Pennsylvania v. Furman*, 165 Pa. Super. 268, 67 A. 2d 590 (liability for annual membership dues is governed by written membership contract); *Pink v. A. A. A. Highway Express*, 314 U. S. 201, 62 S. Ct. 241, 86 L. Ed. 152 (holding that unilateral declaration on insurance policy that each policyholder was a member did not operate to cause certain policyholders to become members where they had done no act signifying consent or assumption of membership).

<sup>15</sup> Arkansas Statutes 1947 Annotated, sec. 77-1026.

<sup>16</sup> Code of Laws of South Carolina 1952, sec. 12-817.

<sup>17</sup> *Pettingill v. State Marketing Association*, 199 Wis. 200, 225 N. W. 834.

<sup>18</sup> *Sun-Maid Raisin Growers of California v. Paul A. Mosesian & Son, Inc.*, 90 Cal. App. 1, 265 P. 828; *Sun-Maid Raisin Growers of California v. K. Arakelian, Inc.*, 90 Cal. App. 10, 265 P. 832.

<sup>19</sup> See secs. 12 and 15 of the Bingham Cooperative Marketing Act of Kentucky, pp. 304 and 305 of Appendix.

<sup>20</sup> See sec. 10 of the Bingham Cooperative Marketing Act of Kentucky, p. 303 of Appendix.

<sup>21</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Galloway v. Mitchell County Electric Membership Corporation*, 190 Ga. 428, 9 S. E. 2d 903. See also *Range v. Tennessee Burley Tobacco Growers Asso-*



and directors who fail to do so accountable for any losses suffered by members by reason of any departure;<sup>22</sup> (5) to bring a suit to protect the interests of an association when the directors, or a majority of them, are parties to the wrongdoing;<sup>23</sup> (6) to require associations of which they are members to account to them correctly and in adequate detail,<sup>24</sup> and to deal with them without discrimination;<sup>25</sup> (7) to challenge the right of directors or officers to act as such;<sup>26</sup> and (8) to examine the books<sup>27</sup> and property<sup>28</sup> of the association. The last right is subject to such restrictions as may have been agreed to and is subject to the further restriction that the request to examine the books and property of the association is made in good faith and with a view to its exercise at a proper time.

The Supreme Court of Ohio has said <sup>29</sup>—

Our conclusion from an examination of many authorities is that, when a stockholder admits, or the fact is found by the court on evidence, that he has acquired his stock for the purpose of creating a basis for the demand to inspect and copy books and papers, and that he intends to use the information sought, when secured, in such manner as will depreciate the value of the assets of the company and the value of the stock of all other stockholders, he is not entitled to a mandatory injunction requiring the corporation to accede to his demand.

The principles stated in the foregoing quotation are applicable to a cooperative whether formed with or without stock.<sup>30</sup> In determining whether a member of an association should be allowed to obtain information with respect to the business of the association, the purpose for which the member is seeking the information and the use to which the information will be put after being obtained should be considered. If the information sought does not relate squarely to the products of the member, or if the effect on the rights and the financial returns of the membership as a whole will be adverse, the officers of an association should be slow in giving the member access to the books and records of the association.

In a Wisconsin case<sup>31</sup> a cooperative brought suit to compel a member to perform his marketing contract. The member sought the unrestricted right to examine the books and papers of the association to obtain informa-

cation, — *Tenn.* —, 298 S. W. 2d 545, in which it was held that the evidence did not establish the charges of waste and mismanagement made by the complainants.

<sup>22</sup> *Fergus Falls Woolen Mills Co. v. Boyum*, 136 Minn. 411, 162 N. W. 516, L. R. A. 1918A 919.

<sup>23</sup> *Loftus v. Farmers' Shipping Association*, 8 S. D. 201, 65 N. W. 1076; *Browne v. Hammett*, 133 S. C. 446, 131 S. E. 612; *Morton v. Morton Realty Co.*, 41 Idaho 729, 241 P. 1014.

<sup>24</sup> *Brown v. Georgia Cotton Growers' Coop. Association*, 164 Ga. 712, 139 S. E. 417; *Johnson v. Staple Cotton Coop. Association*, 142 Miss. 312, 107 So. 2; *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190; *Rhodes v. Little Falls Dairy Company, Inc.*, 230 App. Div. 571, 245 N. Y. S. 432, affirmed in 256 N. Y. 559, 177 N. E. 140.

<sup>25</sup> *Wheelwright v. Pure Milk Association*, 208 Wis. 40, 240 N. W. 769, 242 N. W. 486.

<sup>26</sup> *In re O'Shea*, 269 N. Y. S. 840, 241 App. Div. 699; *Fritz v. Superior Court*, 18 Cal. App. 2d 232, 63 P. 2d 872.

<sup>27</sup> *In re Steinway*, 159 N. Y. 250, 53 N. E. 1103, 45 L. R. A. 461. But the existence of this right does not, alone, justify the appointment of a receiver. *Indianapolis Dairymen's Cooperative, Inc. v. Bottema*, 226 Ind. 237, 79 N. E. 2d 399; 226 Ind. 260, 79 N. E. 2d 409.

<sup>28</sup> *Hobbs v. Tom Reed Gold Min. Co.*, 164 Cal. 497, 129 P. 781, 43 L. R. A. (N. S.) 1112.

<sup>29</sup> *American Mortgage Company v. Rosenbaum*, 114 Ohio St. 231, 151 N. E. 122, 124, 59 A. L. R. 468. See also *Otis-Hidden Co. v. Scheirich*, 187 Ky. 423, 219 S. W. 191, 22 A. L. R. 19, and note thereto.

<sup>30</sup> *State ex rel. Boldt v. St. Cloud Milk Producers' Association*, 200 Minn. 1, 273 N. W. 603; *Futck v. Farmers' Elevator Company*, 142 Iowa 621, 121 N. W. 53, 24 L. R. A. (N. S.) 108.

<sup>31</sup> *Northern Wisconsin Coop. Tobacco Pool v. Oleson*, 191 Wis. 586, 211 N. W. 923, 926.

tion with which to defend the suit. The lower court held that the member had the right to examine the books and papers secretly, but on appeal the supreme court of the State said:

The order, when granted, should be upon affidavit of the defendant or his attorney specifying the particular documents to be examined and a showing of relevancy and materiality. The order should fully protect the plaintiff in its rightful custody of its books and records, and in its right to supervise the examination, to the extent that no improper use shall be made of its records, and that none are misplaced, destroyed, or lost. It should further reasonably limit the time in which the examination shall be made.

Under proper circumstances a shareholder in a cooperative can bring a derivative action to redress wrongs committed against the cooperative. In one such case, it was held that shareholders in a cooperative are not subject to the usual rule restricting actions by shareholders "in right of corporation." The court pointed to the "special character" of a cooperative corporation in reaching this conclusion.<sup>32</sup>

### Termination of Membership

In a cooperative formed with capital stock a person continues to be a member until a valid transfer, redemption, or forfeiture of his stock is effected. He cannot resign.<sup>33</sup> Fundamentally, and this is the rule in the absence of stipulations to the contrary, on the transfer of the stock of an association held by an individual the purchaser stands in the place of the former owner as to rights and liabilities, and the former owner has no further interest in the association and is free from any further liability on account of the stock.<sup>34</sup> Of course, a member of an association may not defeat his marketing contract therewith by a transfer of his stock.

Fundamentally, in a nonstock cooperative a person continues to be a member until he resigns or is expelled, or until his membership is otherwise terminated in accordance with law.

When associations require the payment of annual dues, the failure to pay such dues within the time prescribed does not terminate a membership in the absence of a bylaw or stipulation to that effect; and if such dues are not paid, a suit may be successfully maintained for their recovery.<sup>35</sup>

Although the marketing contract of a stockholder or member has expired, his stock is not forfeited nor is his membership terminated by that fact alone. Many of the cooperative statutes specifically authorize the associations formed under them to adopt bylaws with respect to redemption or forfeiture of stock and termination of membership. Generally, such bylaws require positive and affirmative action, usually by the board of directors, before membership in a nonstock cooperative is terminated and before stock may be forfeited or a stockholder compelled to transfer his stock. The power to expel members is fundamentally in the membership and unless the members have by an appropriate bylaw placed this power in its board of directors, the board would not have authority to expel a member.<sup>36</sup> Prescribed procedure for expulsion of members, or for termination of their memberships, should be carefully followed.<sup>37</sup>

<sup>32</sup> *Northridge Coop. Section No. 1 v. 32nd Ave. Const. Corp.*, 136 N. Y. S. 2d 737.

<sup>33</sup> *Picalora v. Gulf Cooperative Co.*, 123 N. Y. S. 980, 68 Misc. Rep. 331.

<sup>34</sup> *Whitney v. Butler*, 118 U. S. 655, 7 S. Ct. 61, 30 L. Ed. 266.

<sup>35</sup> *LaSalle County Farm Bureau v. Thompson*, 245 Ill. App. 413; *Boston Club v. Potter*, 212 Mass. 23, 98 N. E. 614, Ann. Cas. 1913 C 397.

<sup>36</sup> *State ex rel. Boldt v. St. Cloud Milk Producers' Association*, 200 Minn. 1, 273 N. W. 603.

<sup>37</sup> *People ex rel. Milsom v. East Buffalo Live Stock Association*, 88 App. Div. 619, 84 N. Y. S. 795, affirmed in 179 N. Y. 598, 72 N. E. 1148.

As a general rule, the power of expulsion is in the members as a body and not in the board of directors; and in a Minnesota case<sup>38</sup> in which the statute specifically authorized the adoption of bylaws with respect to expulsion and also authorized the delegation of such power by the members to the board of directors, it was held that, inasmuch as the bylaws that had been adopted in regard to expulsion did not specify who was to exercise the authority, the board of directors was not authorized to do so.

Unless prohibited by a statute, an association is free at the time a producer is admitted to membership to prescribe the conditions under which his membership shall terminate, in the case of a nonstock organization,<sup>39</sup> or the conditions under which he agrees to transfer his stock either to the association or to a person designated by it.<sup>40</sup> Stipulations of this character may be made, as a general rule, although there is no specific statutory authority for them, assuming that they do not conflict with the law.

When an association refused to receive onions from a member because it was unable to obtain a price therefor that would pay marketing costs and the association also refused to allow the member to sell his onions to others, it was held that while the association may have been justified in breaching its contract, it was not within its rights in refusing to allow the member to sell his onions to others and that this entitled him to recover his membership fee of \$300.<sup>41</sup>

A cooperative, which fundamentally and radically amends its articles of incorporation without the consent of a stockholder, may be liable thereto, as a result of such action, for the value of his stock therein.<sup>42</sup>

Fundamentally, the termination of a marketing contract or ceasing to do business with an association does not terminate a membership in a nonstock association<sup>43</sup> or cause a stockholder in a stock association to cease to be a stockholder.

At the time an association is formed, a nonstock association should consider provisions with reference to the termination of membership and an association formed with capital stock should include suitable provisions so that all voting stock may be kept in the hands of active patrons. Consideration should also be given to the inclusion of provisions with respect to suspending the voting power of members or stockholders in the event they become inactive. Under the cooperative statutes, associations usually have great latitude with respect to these matters.

Certificates of membership in nonstock associations are not transferable at common law but may be made so by statute, bylaw, or contract. In associations formed with capital stock, it is generally desirable that the provisions restricting the transfer of stock or giving the association authority to purchase it under certain conditions should be set forth on the certificates of stock. Such provisions are, as a rule, authorized by the cooperative statutes and, even independent of such statutes, are usually held valid.<sup>44</sup>

<sup>38</sup> *State ex rel. Boldt v. St. Cloud Milk Producers' Association*, 200 Minn. 1, 273 N. W. 603.

<sup>39</sup> *Stevenson v. Holstein-Friesian Association of America*, 30 F. 2d 625; *George v. Holstein-Friesian Association of America*, 238 N. Y. 513, 144 N. E. 776.

<sup>40</sup> *Farmers Union Coop. Gin Co. v. Taylor*, 197 Okla. 495, 172 P. 2d 775.

<sup>41</sup> *Guglielmelli v. Walla Walla Gardners' Association*, 157 Wash. 109, 288 P. 251, 77 A. L. R. 385. See also: *Kansas Wheat Growers' Association v. Toothaker*, 128 Kans. 469, 278 P. 716.

<sup>42</sup> *Midland Cooperative Wholesale v. Ranger Cooperative Oil Association*, 200 Minn. 538, 274 N. W. 624, 111 A. L. R. 1521.

<sup>43</sup> *Burley Tobacco Growers' Coop. Association v. Tipton*, 227 Ky. 297, 11 S. W. 2d 119. But see *Hiroshi Kaneko v. Jones*, 235 P. 2d 768 (Ore.).

<sup>44</sup> *Carpenter v. Dummit [Burley Tobacco Growers' Coop. Association]*, 221 Ky. 67, 297 S. W. 695.



## Interest in Association

As cooperatives acquire property and establish reserves, inquiry is frequently made concerning the financial or property interests which members have in their associations. In considering this matter, certain fundamental propositions should be kept in mind. Neither a stockholder of a stock association nor a member of a nonstock association has title to any part of its assets.<sup>45</sup> Again a member or stockholder of an association may be a creditor thereof. He is a creditor not because he is a member or stockholder, but because the association, independent of that fact, owes him money; such indebtedness may exist because the association, usually in a contract or in its bylaws, has agreed to make certain payments to him. Purchase and sale marketing contracts and certificates of indebtedness illustrate this debtor-creditor relationship.

Aside from the claims a member may have against an association as creditor, what financial interest does he have in his association? This question usually does not arise unless a producer ceases to be a member or stockholder. Prior to dissolution, a member or stockholder of an association at common law has no interest therein that he can compel the association to recognize. Money paid by members of an association as membership dues, or fees, or for the purchase of stock; or money deducted by an association in pursuance of authority to do so from the returns received from the sale of products of members, for the purpose of establishing reserves, or for the acquisition of buildings, do not constitute debts owed by the association to the members unless the association has previously agreed to return or pay back the amounts involved.

At common law, if a member resigns or is expelled from a nonstock association, he is entitled to receive nothing therefrom because of this fact. In other words, in nonstock associations one who ceases to be a member for any cause, in the absence of express provisions to the contrary, loses his interest in the corporation and in turn is free from any further liability. In a Florida case<sup>46</sup> certain members withdrew from a fruit-marketing association and then instituted a suit against it to obtain compensation for "their interest" in the association. Apparently there was no provision, either statutory<sup>47</sup> or otherwise, with reference thereto. The court held that the members on withdrawing from the association lost all their rights therein, that all the assets of the association could be used for the benefit of the remaining members, and that nothing was due the members who had withdrawn. In a later Florida case<sup>48</sup> in which the charter of the association provided that "all rights and privileges in said association, belonging to said member" shall cease in the event a member retires therefrom, it appeared that it had been the policy of the association to distribute back to its members at the end of a season all retains not required for general pur-

<sup>45</sup> *Rhode Island Hospital Trust Co. v. Doughton*, 270 U. S. 69, 46 S. Ct. 256, 70 L. Ed. 475, 43 A. L. R. 1374.

<sup>46</sup> *Clearwater Citrus Growers' Association v. Andrews*, 81 Fla. 299, 87 So. 903. See also *Union Benev. Soc. No. 8 v. Martin*, 113 Ky. 25, 67 S. W. 38; *Dade Coal Co. v. Penitentiary Co.*, 119 Ga. 824, 47 S. E. 338; *Henry v. Cox*, 25 Ohio App. 487, 159 N. E. 101; *Missouri Bottlers' Association v. Fennerty*, 81 Mo. App. 525; *Texas Employers Insurance Association v. Humble Oil & Refining Co.*, 103 S. W. 2d 818; *Massaro v. Tampa Better Milk Producers Coop.*, 146 Fla. 64, 200 So. 211; *Liggett v. Koivunen*, 227 Minn. 114, 34 N. W. 2d 345; 5 C. J. 1360, 19 R. C. L. 1267.

<sup>47</sup> This was before the passage of the 1923 cooperative act of Florida, Laws of 1923, ch. 142.

<sup>48</sup> *Ozona Citrus Growers' Association v. McLean*, 122 Fla. 188, 165 So. 625. See also *Adams v. Sanford Growers' Credit Corporation*, 135 Fla. 513, 186 So. 239.

poses, when a sufficient amount of such retains had accumulated. It was held that the executor of a former member "had a right to recover his pro rata part of any surplus on hand arising from 'retains' for handling citrus fruits during his membership." With respect to this amount the member was apparently looked upon as a creditor. The conclusion of the court was presumably affected by the fact that the association was discontinuing operations.

In a California case,<sup>49</sup> suit was brought by the assignee of certain members who withdrew from a dairymen's association to recover amounts which had been deducted by the association from the sums due each member for milk delivered. Such deductions were made for capital purposes pursuant to a bylaw which provided that the capital retained would be distributable only upon the liquidation of the association. The court held that the statute under which the association was incorporated did not require the association to adopt a bylaw providing the manner in which the value of members' interests would be ascertained and providing for their purchase in the event of withdrawal. Although the statute did not specifically authorize the adoption of a bylaw providing for the distribution of the assets of the association on liquidation, the court apparently considered valid the bylaw which had been adopted. It denied recovery to the assignee of the withdrawing members.

A clear distinction should be drawn between amounts claimed by a member under his contract with an association and amounts claimed by him by reason of his membership therein. In an Oregon case,<sup>50</sup> an association that was engaged in growing apples was a member of a marketing association. The former association canceled its membership in the latter and later brought suit against this association on its contract. The court said that:

Under the terms and conditions of the contract, standing alone and complete within itself, the grower is entitled to receive each year the balance of any net proceeds from an annual pool, within 30 days after the receipt of the money by the association, and it is the duty of the association to render an annual statement of the receipts and disbursements of each pool. The record is conclusive that such statement was never made and such accounting was never rendered to the plaintiff; that, after paying the expenses of the association named in the contract, there is a surplus estimated to be about \$80,000.

The marketing association claimed that, by reason of a bylaw which provided that the cancelation of the standard contract shall "cancel and terminate the membership of such grower, together with all benefits accruing thereunder, and all voting power, right, and interest of every kind and nature shall immediately cease and terminate," it was entitled to retain the money in question and that the plaintiff was entitled to no part thereof. The court, however, held that the bylaws did not "apply to a surplus accruing from the sale and purchase of fruit and charges therefor, under an express contract, but are confined and limited to the right, title, and interest which a corporation or individual may have in and to the net assets of the association by reason of membership therein subject to the payment of all of its debts and liabilities. They do not give to the association the right to keep the money which it promised and agreed to pay another under its express contract." In other words, the member was entitled to nothing by reason of his membership, but was entitled to payment in accordance with his marketing contract.

<sup>49</sup> *Driscoll v. East-West Dairymen's Association*, 122 P. 2d 379, 126 P. 2d 467 (Cal.).

<sup>50</sup> *Hood River Orchard Co. v. Stone*, 97 Ore. 158, 191 P. 662, 666. See also *Bogardus v. Santa Ana Walnut Growers' Association*, 41 Cal. App. 2d 939, 108 P. 2d 52. Cf. *Hiroshi Kaneko v. Jones*, 235 P. 2d 768 (Ore.).

If the contracts or bylaws of an association state, for instance, that unless a person is a member of the association at or prior to a specified time, he shall not be entitled to the return of any money advanced by him, then this language is conclusive and bars from any recovery a person who was not a member prior to the time fixed.<sup>51</sup> A member may be estopped by reason of an account stated, or otherwise, from claiming that any part of reserves should be returned to him.<sup>52</sup>

In associations formed with capital stock, at common law, a person on the sale or transfer of his stock has no further interest in the association and no claims against it except such claims as are independent of stock ownership.<sup>53</sup> This is the rule unless it has been changed by statute, by contract, or by a provision in the bylaws.

In contrast with the common law rule applicable to nonstock associations, many of the cooperative statutes providing for the formation of cooperatives require the incorporators of such nonstock associations to state in the articles of incorporation<sup>54</sup> "whether the property rights and interests of each member shall be equal or unequal; and if unequal, the general rule or rules applicable to all members by which the property rights and interests, respectively, of each member may and shall be determined and fixed; and provision for the admission of new members who shall be entitled to share in the property of the association with the old members, in accordance with such general rule or rules." Such statutes also authorize associations formed under them to adopt bylaws relative to the interests of members therein and further provide that "In case of the withdrawal or expulsion of a member, the board of directors shall equitably and conclusively appraise his property interests in the association and shall fix the amount thereof in money, which shall be paid to him within one year after such expulsion or withdrawal."<sup>55</sup> The statutory provisions referred to are applicable only to associations formed under statutes that contain them.

Some associations are authorized in their marketing contracts to make deductions for "creating funds for credits and other general commercial purposes (said funds not to exceed 1 percent of the gross resale price)." Such funds constitute a reserve that may be used for the purposes specified and a member may not successfully sue an association for their return.<sup>56</sup> Such funds might be lost or dissipated in the conduct of the business of an association without liability therefor.

At common law, on the dissolution of a nonstock cooperative, only the persons who are then members are entitled to share in the distribution of the assets remaining after the payment of its debts.<sup>57</sup> In an association formed

<sup>51</sup> *Weber Implement & Automobile Co. v. St. Louis Automobile Mfrs. & Dealers Association*, 181 S. W. 1025 (Mo. App.).

<sup>52</sup> *Mountain View Walnut Growers Association v. California Walnut Growers Association*, 19 Cal. App. 2d 227, 65 P. 2d 80; *Winter Garden Citrus Growers' Association v. Willits*, 113 Fla. 131, 151 So. 509. See also *Rusconi v. California Fruit Exchange*, 101 Cal. App. 750, 281 P. 84.

<sup>53</sup> *Whitney v. Butler*, 118 U. S. 655, 7 S. Ct. 61, 30 L. Ed. 266.

<sup>54</sup> See sec. 8 of Bingham Cooperative Marketing Act of Kentucky, p. 302 of Appendix.

<sup>55</sup> See sec. 10 of Bingham Cooperative Marketing Act of Kentucky, p. 303 of Appendix.

<sup>56</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Burley Tobacco Growers' Coop. Association v. Tipton*, 227 Ky. 297, 11 S. W. 2d 119; *Burley Tobacco Growers' Coop. Association v. Brown*, 229 Ky. 696, 17 S. W. 2d 1002.

<sup>57</sup> *Hopkins v. Crossley*, 138 Mich. 561, 101 N. W. 822; *Clearwater Citrus Growers' Association v. Andrews*, 81 Fla. 299, 87 So. 903. But cf. *Atkinson v. Consumer-Farmer Milk Cooperative, Inc.*, 94 N. Y. S. 2d 891, holding that since the purposes



with stock, only stockholders at the time of the dissolution are entitled to share in the net assets of the association. In a nonstock association, at common law the distribution is made on a pro rata basis, whereas in a stock association the distribution is made on a stock basis.<sup>58</sup>

In associations that have preferred stock, the preferred stockholders by express provision are frequently given preference over the common stockholders in the distribution of the assets of an association on its dissolution.

Before the assets of a cooperative may be distributed among the members or stockholders, the claims which the member and others have against the association as creditors thereof should first be met, if funds are available. For instance, if the association has issued certificates of indebtedness to its members, these should be paid before any distribution is made among members or shareholders because of the fact that they are members or shareholders.

It should be kept in mind that under normal conditions indebtedness of an association arising from marketing contracts, or evidenced by certificates of indebtedness, certificates of interest, or any other similar instrument, is not to be considered as a part of the property rights and interests of members but simply as indebtedness, subject though it may be to certain conditions.<sup>59</sup> In view of this fact the property rights and interests of members would ordinarily be determined only after deducting obligations of the association due its members and others. In an association operating on a revolving-fund basis, it may be that the property rights and interests of members will be nothing, or merely a nominal sum.

## Dissolution

Associations are formed by the State, and the charter represents an agreement between the State and the incorporators.<sup>60</sup> Because of the manner in which corporations are created, the State has control over their dissolution. There are State statutes with respect to this matter. Through unanimous consent on the part of the members of an association, it may be dissolved.<sup>61</sup>

The right of a majority of the stockholders or members at common law to force dissolution of a corporation against the opposition of the minority is not so well established. Some authorities hold that the majority can force a dissolution,<sup>62</sup> whereas a contrary doctrine has been laid down.<sup>63</sup> Of course, if there are statutory or charter provisions on the subject, they control.<sup>64</sup>

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and activities of the nonstock consumer cooperative involved in this case were essentially of a charitable and public character, the members of the corporation had no rights, vested or contingent, in its assets upon dissolution, and such assets must be distributed in accordance with the doctrine of *cy pres*.

<sup>58</sup> *Krebs v. Carlisle Bank*, 14 Fed. Cases 856, Fed. case No. 7932; *Central Sav. Bank v. Smith*, 43 Colo. 90, 95 P. 307.

<sup>59</sup> See Revolving-Fund Plan of Financing, p. 223.

<sup>60</sup> *Syrian Antiochian St. George Orthodox Church v. Ghize*, 258 Mass. 74, 154 N. E. 839.

<sup>61</sup> *Mobile & Ohio R. R. Co. v. The State*, 29 Ala. 573, 586.

<sup>62</sup> *State ex rel. Majority of Stockholders of Chilhowee Woolen Mills Co. v. Chilhowee Woolen Mills*, 115 Tenn. 266, 89 S. W. 741, 2 L. R. A. (N. S.) 493, 112 Am. St. Rep. 825.

<sup>63</sup> *Polar Star Lodge v. Polar Star Lodge*, 16 La. Ann. 53; *Stockholders of Jefferson County Agr. Association v. Jefferson County Agr. Association*, 155 Iowa 634, 136 N. W. 672; *Theis v. Spokane Falls Gaslight Co.*, 34 Wash. 23; 74 P. 1004.

<sup>64</sup> *Farmers Union Cooperative Brokerage v. Palisade Farmers Union Local No. 714*, 69 S. D. 126, 7 N. W. 2d 293.

In many States the directors of a corporation at the time of its dissolution continue for some time thereafter to act as trustees with reference to the payment of obligations of the corporation and the proper distribution of its assets.<sup>65</sup>

### Expiration of Charter

A corporation may cease to exist through the expiration of its charter if the duration of the corporation is limited, or its charter may be forfeited by the State for unauthorized or unlawful action or conduct,<sup>66</sup> or the charter may be repealed through the reserved power of the State.<sup>67</sup> A charter also may be canceled by the State for fraud in its procurement.<sup>68</sup>

The dissolution of a corporation is not effected by its failure to elect officers or by a sale or assignment of all its corporate property and by a cessation of all corporate acts.<sup>69</sup>

It has been held that the failure of the corporation to file its annual reports with the secretary of state does not *ipso facto* forfeit the corporate charter or revoke its right to do business. Until the State takes some action based on the default, the corporate rights are unaffected.<sup>70</sup>

The fact that an association is placed in the hands of a receiver does not effect a dissolution;<sup>71</sup> nor does the bankruptcy of an association result in its dissolution.<sup>72</sup>

If those interested in an association continue to do business in its name after the expiration of the charter, or after the dissolution of the association, they may incur personal responsibility and liability.<sup>73</sup>

In some of the States there are statutes providing for the renewal of charters of corporations that are about to expire, or after they have expired, provided that an application for renewal is filed, usually with the secretary of state, before a certain date.<sup>74</sup>

### Merger or Consolidation

There are statutes in most States providing for the merger or consolidation of corporations, including cooperative corporations. In any instance in which it is proposed to merge or consolidate cooperative corporations, these statutes should be followed strictly. The Federal antitrust laws<sup>75</sup> place certain limitations on mergers or consolidations and these, also, require consideration.

<sup>65</sup> *Kansas Wheat Growers' Association v. Markley*, 132 Kan. 156, 294 P. 885.

<sup>66</sup> *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231.

<sup>67</sup> *Swan Land & Cattle Co. v. Frank*, 148 U. S. 603, 13 S. Ct. 691, 37 L. Ed. 577; *State ex rel. Shields v. Farmers Union Cooperative Brokerage*, 70 S. D. 14, 13 N. W. 2d 809.

<sup>68</sup> *State ex rel. Southerland v. U. S. Realty Imp. Co.*, 15 Del. Ch. 108, 132 A. 138.

<sup>69</sup> *Brock v. Poor*, 216 N. Y. 387, 111 N. E. 229; *Belle City Malleable Iron Co. v. Clark*, 172 Minn. 508, 215 N. W. 855. See also *Hendrickson v. Bloom*, 159 Ore. 428, 80 P. 2d 868.

<sup>70</sup> *Indianapolis Dairymen's Cooperative, Inc. v. Bottema*, 226 Ind. 237, 79 N. E. 2d 399; 226 Ind. 260, 79 N. E. 2d 409.

<sup>71</sup> *Riverside Oil & Refining Co. v. Lynch*, 114 Okla. 198, 243 P. 967.

<sup>72</sup> *State ex rel. McCoy v. Farmers' Coop. Packing Co.*, 50 S. D. 627, 211 N. W. 602; *Haynes v. Central Business Property Co.*, 140 Wash. 596, 249 P. 1057; *Petrogradsky Mejdunarodny Kommerchesky Bank v. National City Bank of New York*, 253 N. Y. 23, 170 N. E. 479.

<sup>73</sup> *Burks v. Weast*, 67 Cal. App. 745, 228 P. 541.

<sup>74</sup> *Missouri Slope Agricultural & Fair Association v. Hall, Secretary of State*, 46 N. D. 300, 177 N. W. 369; *Terrell v. Ringgold County Mutual Telephone Co.*, 225 Iowa 994, 282 N. W. 702.

<sup>75</sup> 15 U. S. C. A. 18.

If there are statutory provisions for merger or consolidation at the time a person becomes a stockholder in a corporation, these provisions become a part of his contract with the corporation. Where the consolidation provisions are fair and reasonable, the stockholders of the associations entering into the consolidation are required to accept them.<sup>76</sup>

### Reorganization of Associations

Frequently it is desired to reorganize a corporation handling agricultural commodities, so that it will be an agricultural cooperative in organization and operation. Generally, such a reorganization involves restriction of the voting rights to producers, restriction of the returns on capital to not more than 8 percent per annum, provision for the payment of patronage dividends, and elimination of the voting rights of nonproducers. It may also be deemed advisable to limit the number of shares which any stockholder may own.

In this connection attention is called to the fact that, for a cooperative to be eligible to borrow from a bank for cooperatives, or to be eligible for an "exempt" status under the Internal Revenue Code, it is necessary that substantially all the voting rights in an association be vested in actual producers. As indicated, one of the problems arising in most reorganization cases is how to achieve this result. If the nonproducer members are willing to accept nonvoting preferred stock, revolving-fund certificates, or some other form of certificate that does not carry a vote, then little difficulty should be encountered. On the other hand, if some of or all the nonproducer voting members are unwilling to make such an exchange, an association is confronted with the problem of how such persons may be eliminated from the organization. Generally speaking, if neither the statute under which an organization is incorporated, nor its charter, bylaws, or stock certificates provide for doing so, then an amendment to the articles of incorporation or bylaws may not be adopted to accomplish this purpose, which is binding on the nonproducer members who do not consent thereto.

On the other hand, it appears that a bylaw which restricts the right to transfer stock to bona fide producers at least would be effective against all members of the association who voted in favor of its adoption and producers who became members subsequent to its adoption and, in general, against third persons who might have knowledge thereof. In this connection it was said in a Michigan case:<sup>77</sup>

The contention is made on behalf of appellants that this bylaw is void for various enumerated reasons. The authorities upon this point are not uniform, and though the question is one of interest, we have found it unnecessary to pass upon it in this case, for the reason that whether valid or void, considered strictly as a bylaw, it can be sustained as an agreement entered into between all the parties in interest. It should be noted that we are not called upon here to determine the effect of such a bylaw upon a stockholder who had not given his assent to its adoption, or upon a transferee of stock, who in good faith, for value, and without notice had become an owner of shares in the corporation. We are now dealing only with stockholders who themselves, voluntarily and for their own benefit and protection, enacted the bylaw.

<sup>76</sup> *Pearson v. Clam Falls Cooperative Dairy Association*, 243 Wis. 369, 10 N. W. 2d 132.

<sup>77</sup> *Weiland v. Hogan*, 177 Mich. 626, 143 N. W. 599, 601. See also *Falcone v. Societa*, 61 N. Y. S. 873, 30 Misc. 106; *Farrier v. Ritzville Warehouse Co.*, 116 Wash. 522, 199 P. 984; *Bank of Atchison County v. Durfee*, 118 Mo. 431, 24 S. W. 133, 40 Am. St. Rep. 396; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 12 Hun. 53; *Bessette v. St. Albans Cooperative Creamery*, 107 Vt. 103, 176 A. 307; *Searles v. Bar Harbor Banking & Trust Company*, 128 Me. 34, 145 A. 391, 65 A. L. R. 1154.



Again if a bylaw is adopted restricting the membership to producers who patronize the association, this would operate to prevent the association from admitting to membership persons who do not possess the requisite qualifications. In addition, it should be of help in preventing the transfer of voting stock by members, who voted in favor of the adoption of the bylaw, to ineligible persons. Thus, under such a bylaw an association over a period of time should be able materially to increase the percentage of its voting stock held by producers. Moreover, no reason is apparent why such a bylaw, in the case of a stock association, should not require the stock certificates issued subsequent to its adoption to carry on their face the restrictions on the right to own and transfer shares of stock evidenced thereby.

If an association is financially able to do so and the rights of creditors will not be adversely affected, it may be possible to purchase the stock of nonproducer members at prices which are mutually agreed upon. If stock may not be acquired in this way it may be found practicable to form a new association, the voting membership of which is restricted to producers, and then to have the new association acquire the assets of the old one. It is not always possible to do this if stockholders protest, particularly if the corporation is a successful one. Moreover, there are statutes in probably all States which deal specifically with the sale of all the assets of a going corporation and these should be strictly followed. A rule which, with some variations, exists in many States is one to the effect that a corporation may not dispose of all its assets unless it is in a failing condition, without the consent of a specified percentage of its stockholders. It has been said <sup>78</sup> that—

At common law neither the directors of a corporation nor a majority of its stockholders had the right, power, or authority to sell and convey all the property of a going and prosperous corporation capable of achieving the objects of its creation as against the objections of a single stockholder.

In many instances, however, it will be found possible to form a cooperative and effect a sale to it of all the assets of the old organization. This must be done on a basis which is fair and just. Ordinarily, in such a situation the members of the old organization who are desirous of becoming members of the new one, take stock certificates, or certificates of some other character, equal in amount to their interest in the old organization. Only producers who are to patronize the new association are given certificates carrying voting rights; the certificates given to others would not carry a vote. This would mean, in the last analysis, that the only persons who would receive cash for their interests in the old organization would be those persons who were unwilling to accept some form of certificate or obligation of the new organization.

If the organization papers of a corporation that is being reorganized provide for the distribution of earnings on a stock basis, it may not be possible to provide for the distribution of all earnings on a patronage basis without the consent of all stockholders. In a Nebraska case <sup>79</sup> in which this was attempted the court said:

The original articles and the laws then in force made dividends on stock the means of distributing profits. On this basis plaintiffs bought stock and invested money.

<sup>78</sup> *Voigt v. Remick*, 260 Mich. 198, 244 N. W. 446, 449, certiorari denied, 289 U. S. 756, 53 S. Ct. 787, 77 L. Ed. 1500; *Michigan Wolverine Student Cooperative, Inc. v. Wm. Goodyear & Co.*, 314 Mich. 590, 22 N. W. 2d 884. A sale of all of a cooperative's assets by unanimous consent of the members is, of course, permissible. *Autauga Cooperative Leasing Association v. Ward*, 250 Ala. 229, 33 So. 2d 904.

<sup>79</sup> *Allen v. White*, 103 Neb. 256, 171 N. W. 52; *Huefle v. Farmers Elevator*, 145 Neb. 424, 16 N. W. 2d 855. See also 10 Cyc. 355.

They thus entered into a contract of which the original articles of incorporation and the laws applicable thereto were by construction material parts. \* \* \* In this way plaintiffs acquired the contractual right to share the net profits in the form of dividends on stock. \* \* \* In 1916 there was an attempt to amend the articles of incorporation by changing the Farmers' Elevator Co. to a cooperative association within the meaning of the statute cited. Later defendants planned to distribute profits under the amendment. Such a course, if pursued, would deprive plaintiffs of dividends to which they were entitled under their contracts as original stockholders and would destroy their contractual rights. This, neither the legislature nor the defendants can lawfully do.

On principle it would seem that the holding in the case last cited would apply to an attempt to restrict the amount that might be paid as dividends on stock unless all stockholders consented thereto or acquiesced therein.

The cooperative marketing acts of many States contain provisions reading substantially as follows:

*Associations heretofore organized may adopt the provisions of this Act.*—Any corporation or association, organized under previously existing statutes, may, by a majority vote of its stockholders or members, be brought under the provisions of this act by limiting its membership and adopting the other restrictions as provided herein. It shall make out in duplicate a statement signed and sworn to by its directors to the effect that the corporation or association has, by a majority vote of the stockholders or members, decided to accept the benefits and be bound by the provisions of this act and has authorized all changes accordingly. Articles of incorporation shall be filed as required in K. S. section 883f-8, except that they shall be signed by the members of the then board of directors. The filing fee shall be the same as for filing an amendment to articles of incorporation.<sup>80</sup>

The Supreme Court of Minnesota expressed doubt as to the constitutionality of a similar statutory provision.<sup>81</sup>

In a North Dakota case<sup>82</sup> in which the Secretary of State refused to accept an amendment to articles of incorporation prepared in pursuance of a statutory provision similar to that quoted above, the court held—

that the secretary of state cannot be heard to assert in this proceeding that the rights of nonconsenting stockholders have been or may be violated.

and ruled that the amendment must be filed by him.

In a Kansas case,<sup>83</sup> it was held that a private stock corporation could bring itself under the provisions of the Cooperative Marketing Act of Kansas, which contained a provision similar to that quoted above, but "that cannot be construed as a grant of power to the majority to do as they pleased with the property and property rights of the minority." The effect of the court's decision was to require the issuance to minority stockholders of securities at least equal to the book value of the stock which they held in the old corporation. The reorganization plan sought to compel the minority stockholders to take certificates of indebtedness worth less than half the book value of the stock in the old corporation.

It appears clear that, until an association elects to come under the provisions of a particular cooperative act, it continues to operate and to be subject to the statute under which it was organized.<sup>84</sup>

In a Florida case in which the successor to a cooperative took over all its assets, it was held that the new association was bound to carry out the

<sup>80</sup> See sec. 25 of Bingham Cooperative Marketing Act of Kentucky, p. 306 of Appendix.

<sup>81</sup> *Maclaren, as Receiver of Goodhue County Cooperative Company v. Wold*, 168 Minn. 234, 210 N. W. 29, 55 A. L. R. 321, 172 Minn. 334, 215 N. W. 428.

<sup>82</sup> *Mohall Farmers' Elevator Company v. Hall*, 44 N. D. 430, 176 N. W. 131, 133. See also *Equity Cooperative Packing Company v. Hall*, 42 N. D. 523, 173 N. W. 796.

<sup>83</sup> *Hill v. Partridge Cooperative Equity Exchange*, 168 Kan. 506, 214 P. 2d 316.

<sup>84</sup> *State ex rel. Koski v. Kylmanen*, 178 Minn. 164, 226 N. W. 401, 14a C. J. 74.

terms and conditions of a retain certificate when its holder refused to accept an interest in the new organization in substitution for an interest in the old one under the certificate.<sup>85</sup>

A creamery association, attempting to operate a nonprofit business cooperative, reorganized and became a nonprofit marketing association. Members, who only had the right under the bylaws of the former association to receive back their membership fee upon withdrawing, were given the option of continuing as members of the new association, if qualified, with their proportionate interest apportioned to them on the association's books, or withdrawing. In the latter case they were paid the membership fee in cash and were credited on the books of the association with an additional amount equal to their share of the net worth, less such fee. The court held that under this plan dissenting members were not deprived of vested rights or any property without just compensation.<sup>86</sup>

Sometimes some of the members of an unincorporated association, without the consent of all its members, incorporate an association with the thought that it will supersede the old association. If all the members of the unincorporated association, or the number required by its organization papers, have not agreed that a corporation may be formed to take the place of the unincorporated one, serious legal difficulties may result. Under such circumstances, officers of such a corporation act at their peril in using funds derived from the unincorporated association.<sup>87</sup>

The question is sometimes asked whether a cooperative which has been operating with a number of local units may reorganize by turning over to the members in each locality the assets which it had previously there employed, each local unit to function thereafter as an individual association. While in some instances a plan of this kind may be worked out, this may not be done if creditors of the original association would be prejudiced thereby.<sup>88</sup>

## Board of Directors

MEMBERSHIP on the board of directors of a cooperative is ordinarily looked upon as a post of honor, but the board member who has examined the statutes and court decisions on the subject will also look upon the office as a post of great legal responsibility. Not only does the welfare of the cooperative rest upon the board as a group, but the office of director carries with it the possibility of large personal liability both at common law and under statutes.

In the discussion which follows, the rules and principles stated are the common law rules, unless a statutory provision is referred to; and they are as applicable to directors of cooperative corporations as to directors of corporations of any other type.

First, all the corporate powers of an association, other than those specifically conferred on the members, are in its directors; that is, the directors of an association collectively and primarily possess all the powers that the association has under the law.<sup>89</sup> It is true that these powers are executed

<sup>85</sup> *Merker v. Lake Region Packing Association*, 126 Fla. 589, 172 So. 702.

<sup>86</sup> *De Mello v. Dairymen's Cooperative Creamery*, 73 Cal. App. 2d 746, 167 P. 2d 226.

<sup>87</sup> See *Strong v. Los Nietos & Ranchito Walnut Growers' Association*, 137 Cal. 607, 70 P. 734; *Hamaty v. St. George Ladies' Society*, 280 Mass. 58, 181 N. E. 775; *Bentley v. Hurley*, 222 Mo. App. 51, 299 S. W. 604.

<sup>88</sup> *John H. Lebens, as Receiver of the LeSueur County Cooperative Company v. Nelson*, 148 Minn. 240, 181 N. W. 350.

<sup>89</sup> *Elggren v. Woolley*, 64 Utah 183, 228 P. 906; *Federal Land Bank of St. Louis v. Bross*, 122 S. W. 2d 35 (Mo.).



by the officers, agents, and employees of the association, but the authority for their acts is found in the board of directors. They determine either expressly or by implication, directly or indirectly, the acts to be performed and the plans and methods to be followed by the officers, agents, and employees of the association.<sup>90</sup> It is the function and duty of directors of an association to direct and supervise in a fundamental way the activities of the association. The members or stockholders of an association, through appropriate bylaws, undoubtedly could prescribe rules which the directors should observe in the conduct of the business of the association, for it will be remembered that a director is an agent and the general rules of agency apply to him in his relation to the corporation.<sup>91</sup>

The first directors of a cooperative, under the statutes providing for the formation of such associations, are usually named in the articles of incorporation. In general practice they are the incorporators. These directors are sometimes referred to as the incorporating directors, and they are usually authorized to serve until their successors are elected and qualified. The members or stockholders elect the successors to these directors, usually at a special meeting or at the first annual meeting of the association.

Unless required by statute, charter, or bylaws, it is not necessary that directors be members of the association.<sup>92</sup> Directors are elected for specified periods of service, sometimes prescribed in the law of the State; but usually upon the expiration of the term for which elected, a director does not thereby cease to be a director, but continues as such, barring resignation or expulsion, with all the rights and responsibilities incident thereto until the election and qualification of his successor.<sup>93</sup> Generally speaking, the cooperative statutes specifically authorize associations incorporated under them to adopt bylaws prescribing the qualifications which must be possessed by persons in order that they may be eligible to be directors. Such bylaws, if reasonable, are valid. A bylaw has been upheld providing that, if a person ceases to have the qualifications required for a director, the office of director thereby becomes vacant.<sup>94</sup> Persons who become ineligible to be directors have been held to be de facto directors.<sup>95</sup> When a corporation in pursuance of action taken by a de facto board of directors entered into a contract with a person who was acting in good faith, the contract was binding on the corporation.<sup>96</sup>

Ordinarily, it would appear to be better practice and procedure for the bylaws of an association to provide that a person ceases to be a director upon action being taken either by the board of directors or by the membership.

<sup>90</sup> *Monterey Water Company v. Voorhees*, 45 Ariz. 338, 43 P. 2d 196.

<sup>91</sup> *Fleischer v. Pelton Steel Company*, 183 Wis. 151, 198 N. W. 444; *Nicholson v. Kingery*, 37 Wyo. 299, 261 P. 122; *Holcomb v. Forsyth*, 216 Ala. 486, 113 So. 516; *Johnson v. York Coal & Coke Company*, 182 Ky. 303, 206 S. W. 611; *Keenan v. Zemaitis*, 4 F. 2d 572. But see *Security Savings & Trust Company v. Coos Bay Lumber & Coal Company*, 219 Wis. 647, 263 N. W. 187.

<sup>92</sup> *Wright v. Floyd*, 43 Ind. App. 546, 86 N. E. 971; *Wight v. Springfield & New London Railroad Co.*, 117 Mass. 226, 19 Am. Rep. 412; *Parsons v. Rinard Grain Co.*, 186 Iowa 1017, 173 N. W. 276.

<sup>93</sup> *Lucky Queen Min. Co. v. Abraham*, 26 Ore. 282, 38 P. 65; *Grant v. Elder*, 64 Colo. 104, 170 P. 198; *Weil v. Defenbach*, 36 Idaho 37, 208 P. 1025.

<sup>94</sup> *Johnson v. York Coal & Coke Company*, 182 Ky. 303, 206 S. W. 611; *Chemical National Bank of New York v. Colwell*, 132 N. Y. 250, 30 N. E. 644.

<sup>95</sup> *In re Ringler & Company*, 204 N. Y. 30, 97 N. E. 593, Ann. Cas. 1913-C, 1036; *Richards v. Farmers' & Mechanics' Institute of Northampton County*, 154 Pa. 449, 26 A. 210, 35 Am. St. Rep. 848.

<sup>96</sup> *Richards v. Farmers' & Mechanics' Institute of Northampton County*, 154 Pa. 449, 26 A. 210, 35 Am. St. Rep. 848.

A director or officer of an association at common law may resign at will,<sup>97</sup> and a statute providing that directors shall hold office for 1 year and until their successors have been elected and qualified does not prevent resignation during the year.<sup>98</sup>

It is customary to provide in the bylaws that vacancies on the board may be filled temporarily by action of the remaining board members until the next meeting of the members or stockholders. Such a procedure is usually authorized also by the State corporation law. Such a provision, however, does not confer authority on the board of directors to fill newly created directorships.<sup>99</sup>

A director of a cooperative, like the director of any other corporation, is not by reason of this fact an agent of the cooperative, insofar as transactions with third persons are concerned, and where the maker of a note held by an association paid one of its directors, this did not constitute payment to the association.<sup>1</sup>

It has been held that a contract entered into by a corporation under which its management and control is turned over to another and the power of its board of directors is in effect suspended is invalid, as against public policy.<sup>2</sup>

A cooperative was authorized by its charter to buy and sell grain. It was held that this might be done on a board of trade operating under the Federal Grain Futures Act<sup>3</sup> and the fact that losses resulted from such transactions did not render the directors personally liable.<sup>4</sup>

### Compensation of Directors

The directors of an association have no inherent power to fix their own compensation as directors or, if they are officers, their salaries or other compensation as officers.<sup>5</sup> In other words, unless the statute under which an association is formed, its articles of incorporation, or an authorized bylaw permits directors to fix their own compensation, they do not have such authority, but in some instances authority to determine the salaries of officers is placed by statute in the board of directors. This authority is possessed by the members of an association, who may, through appropriate bylaws or otherwise, either fix the compensation of the directors of an association or authorize the fixing of such by the board of directors. Both the directors and the officers of a corporation are presumed to act without compensation in performing the duties of their offices unless provision for compensating them has been made,<sup>6</sup> but if any of them are working regularly for the corporation with respect to matters not involving their duties as directors or officers, it will be assumed that reasonable compensation will be made by the corporation for such services.<sup>7</sup>

<sup>97</sup> *Ewald v. Medical Society*, 130 N. Y. S. 1024, 70 Misc. 615, reversed on other grounds 128 N. Y. S. 886, 144 App. Div. 82.

<sup>98</sup> *Briggs v. Spaulding*, 141 U. S. 132, 11 S. Ct. 924, 35 L. Ed. 662.

<sup>99</sup> *Automatic Steel Products, Inc. v. Johnston*, 31 Del. Ch. 469, 64 A. 2d 416.

<sup>1</sup> *Hudson Cooperative Loan Association v. Horowitz*, 116 N. J. L. 605, 186 A. 437.

<sup>2</sup> *Sherman & Ellis v. Indiana Mutual Casualty Company*, 41 F. 2d 588. See also *Continental Oil Company v. Jones*, 26 F. Supp. 694.

<sup>3</sup> 7 U. S. C. A. 1.

<sup>4</sup> *Clark v. Murphy*, 142 Kan. 426, 49 P. 2d 973. See also *South Carolina Cotton Growers' Coop. Association v. Weil*, 220 Ala. 568, 126 So. 637; *Burch v. South Carolina Cotton Growers' Coop. Association*, 181 S. C. 295, 187 S. E. 422.

<sup>5</sup> *Bennett v. Kliepto Loose Leaf Co.*, 201 Iowa 236, 207 N. W. 228; *Holcomb v. Forsyth*, 216 Ala. 486, 113 So. 516; *Security Savings & Trust Company v. Coos Bay Lumber & Coal Company*, 219 Wis. 647, 263 N. W. 187.

<sup>6</sup> *First National Bank of Allen v. Daugherty*, 122 Okla. 47, 250 P. 796.

<sup>7</sup> *Navco Hardwood Co. v. Bass*, 214 Ala. 553, 108 So. 452.

Many of the cooperative statutes state that "an association may provide a fair remuneration for the time actually spent by its officers and directors in its service." In this language, or in language similar thereto, the word association<sup>8</sup> means members; and under such language the directors or officers are not authorized to fix their own salaries or compensation. The bylaws should contain suitable provisions on this subject.

## Meetings of the Board

How must the directors who compose the board act to bind the association? " \* \* \* in order to bind the corporation, the board must act and act as a board either in a regular session or in a special session called for the purpose."<sup>9</sup> In other words, the rule is established that in matters affecting the property or policies, or involving the exercise of discretion, the directors can bind the association only when acting as a board in a properly convened meeting. A director merely by virtue of his office has no authority to act for or bind an association except in meetings of the board of directors; and if a director by virtue of his office should attempt, for instance, to release a member from his contract the act would be void.<sup>10</sup>

Even a majority of the board acting as individual directors or in a "board meeting," illegal for any reason, cannot bind the association.<sup>11</sup> In an Arkansas case<sup>12</sup> a cooperative executed a general assignment but as it was "authorized" at an illegal meeting of its directors the assignment was void as against an attaching creditor. This was in accordance with the general rule under which a stockholder director, officer, the corporation itself, or a creditor may question the validity of transactions based on action taken at a meeting of a board of directors which was illegal for any reason.

It is highly important, therefore, for the officers of cooperatives to be authorized by their boards of directors at legal meetings to transact the business in which they engage; and, likewise, associations in dealing with other corporations should satisfy themselves that the officers of such corporations are legally authorized to act.<sup>13</sup> Action by directors at an illegal board meeting may be adopted and ratified at a later legal meeting of the board, but directors who were not notified of a board meeting cannot later, as individuals, waive the failure to give notice or concur in the action taken at the illegal meeting so as to bind the association.<sup>14</sup> It appears that a director may waive notice of a board meeting prior thereto,<sup>15</sup> but this cannot be done subsequently so as to validate the action taken. If a director has notice, and fails to attend the board meeting, his absence does not affect action taken, provided a qualified quorum was present.

<sup>8</sup> *Railway Company v. Allerton*, 85 U. S. 233, 21 L. Ed. 902.

<sup>9</sup> *Jackson v. Bonneville Irr. Dist.*, 66 Utah 404, 243 P. 107, 111; *Honaker v. New River, H. & W. R. Co.*, 116 Va. 662, 82 S. E. 727; *Nicholson v. Kingery*, 37 Wyo. 299, 261 P. 122; *Raish v. Orchard Canal Co.*, 67 Mont. 140, 218 P. 655.

<sup>10</sup> *California Canning Peach Growers v. Harris*, 91 Cal. App. 654, 267 P. 572; see Annotation "Informality of meeting of directors as affecting action taken thereat," 64 A. L. R. 712.

<sup>11</sup> *United States v. Interstate R. Co.*, 14 F. 2d 328.

<sup>12</sup> *Simon v. Sevier County Cooperative Association*, 54 Ark. 58, 14 S. W. 1101.

<sup>13</sup> See also *Red Bud Realty Company v. South*, 96 Ark. 281, 131 S. W. 340; Annotation "Informality of meeting of directors as affecting action taken thereat," 64 A. L. R. 712, 726.

<sup>14</sup> *United States v. Interstate R. Co.*, 14 F. 2d 328.

<sup>15</sup> *Holcombe v. Trenton White City Co.*, 80 N. J. Eq. 122, 82 A. 618; *United States v. Interstate R. Co.*, 14 F. 2d 328.



## Quorum

What constitutes a quorum of the board of directors? At common law and in the absence of a statutory, charter, or bylaw provision changing the rule, the general rule is that a majority of directors of a corporation who are not personally interested in the subject before the board, and who are otherwise qualified, is necessary to constitute a quorum of the board of directors for the transaction of business.<sup>16</sup> Thus, if a majority of qualified directors or the number, if any, specified in the statute, the charter or the bylaws, do not attend a duly called board meeting, any business transacted by the minority at such meeting is at least voidable. Directors cannot vote by proxy.<sup>17</sup> It has been held that a transaction may not be successfully attacked by one who is not a party thereto because a quorum of the board of directors was not present at the meeting of the board at which it was "authorized."<sup>18</sup>

If a qualified quorum is present at a properly convened board meeting, a majority thereof at common law may exercise any powers vested in the board of directors.<sup>19</sup> There ceases to be a quorum when a director who is necessary to a quorum withdraws from a meeting. It has been held that the failure of a director to vote upon a proposition before the board, if his vote is necessary in order to constitute a quorum, results in no quorum with respect to that matter.<sup>20</sup> On the other hand, in some States a director present but not voting is counted for the negative.<sup>21</sup> If a statute or bylaw requires, say a two-thirds vote of the members present, the failure of members present to vote renders the action taken a nullity if two-thirds of those present do not vote therefor.<sup>22</sup>

All the foregoing is based upon the theory that each director who attends the meeting is qualified to act because "All of the directors constituting a quorum must be qualified to act. If one of the directors whose presence is necessary to constitute a quorum, or whose vote is necessary to constitute a majority of a quorum, is disqualified by reason of his personal interest, any act done by the body is invalid,"<sup>23</sup> or at least voidable. Some courts apparently hold that a director who is personally interested in a proposition may be counted in determining if a quorum was present at the time the proposition was voted upon, leaving its validity, after subjecting it to severe scrutiny, to depend upon its fairness toward, and effect upon, the corporation, with the burden of showing its fairness on the director.<sup>24</sup>

## Conflicting Personal Interests

If a resolution is adopted on a vote of interested directors, the resolution generally is voidable at the option of the association, if timely action with

<sup>16</sup> *In re Webster Loose Leaf Filing Co.*, 240 F. 779; *Stanton v. Occidental Life Ins. Co.*, 81 Mont. 44, 261 P. 620; *Cardin Bldg. Co. v. Smith*, 125 Okla. 300, 258 P. 910.

<sup>17</sup> *Haldeman v. Haldeman*, 176 Ky. 635, 197 S. W. 376; *In re Acadia Dairies, Inc.*, 15 Del. Ch. 248, 135 A. 846.

<sup>18</sup> *Robertson v. Hartman*, 6 Cal. 2d 408, 57 P. 2d 1310.

<sup>19</sup> *In re Webster Loose Leaf Filing Co.*, 240 F. 779.

<sup>20</sup> *North Louisiana Baptist Association v. Milliken*, 110 La. 1002, 35 So. 264.

<sup>21</sup> *Commonwealth v. Wickersham*, 66 Pa. 134; *Stephany v. Liberty Cut Glass Works*, 76 N. J. Law 449, 69 A. 967.

<sup>22</sup> *James R. Kirby Post No. 50 v. American Legion*, 258 Mass. 434, 155 N. E. 462.

<sup>23</sup> *In re Webster Loose Leaf Filing Co.*, 240 F. 779, 785; *Smith v. Los Angeles I. & L. Coop. Association*, 78 Cal. 289, 20 P. 677, 12 Am. St. Rep. 53; *Holcomb v. Forsyth*, 216 Ala. 486, 113 So. 516; *Stanton v. Occidental Life Ins. Co.*, 81 Mont. 44, 261 P. 620.

<sup>24</sup> *Nicholson v. Kingery*, 37 Wyo. 299, 261 P. 122.

respect thereto is taken, and at least in some jurisdictions the "rule is equally applicable where the interests of other persons, not directors, are affected by the resolution."<sup>25</sup>

In fact, in some jurisdictions, if a member of a board of directors votes upon a proposition which is adopted and in which he has a personal interest, the action of the board may be set aside by the corporation, although the resolution would have been adopted apparently without the vote of the interested directors,<sup>26</sup> and in some States, a resolution of the type in question may be set aside by nonconsenting members of the corporation.<sup>27</sup>

As illustrating matters that would disqualify directors of an association from voting, if personally interested, or would at least bring the validity of the transaction into question, may be mentioned the sale of property of a director to the association,<sup>28</sup> the giving of a mortgage on association property to a director,<sup>29</sup> the execution of association notes to him,<sup>30</sup> or any transaction in which the personal interests of the director would be adverse to those of the association.<sup>31</sup> "In such cases, the court will not pause to inquire whether a director or trustee has acted fairly or unfairly; being interested in the subject matter, he may not as a trustee or director deal with himself and thus be subjected to the temptation to advance his own interest."<sup>32</sup>

Another court has declared:

It is a thoroughly well-settled equitable rule that anyone acting in a fiduciary relation shall not be permitted to make use of that relation to benefit his own personal interest. This rule is strict in its requirements and in its operation. It extends to all transactions where the individual's personal interests may be brought into conflict with his acts in the fiduciary capacity, and it works independently of the question whether there was fraud or whether there was good intention.<sup>33</sup>

In this connection, the Supreme Court of the United States has said:

It is among the rudiments of the law that the same person cannot act for himself and at the same time, with respect to the same matter, as the agent of another whose interests are conflicting. \* \* \* The law, therefore, will always condemn the transactions of a party on his own behalf when, in respect to the matter concerned, he is the agent of others, and will relieve against them whenever their enforcement is seasonably resisted. Directors of corporations, and all persons who stand in a fiduciary relation to other parties, and are clothed with power to act for them, are subject to this rule; they are not permitted to occupy a position which will conflict with the interest of parties they represent and are bound to protect. They cannot, as agents or trustees, enter into or authorize contracts on behalf of those for whom they are appointed to act, and then personally participate in the benefits.<sup>34</sup>

At common law any transaction entered into by a director or officer of an association with anyone, which might conflict with his duty to the association, is voidable. For instance, an agreement by a director or officer of a cooperative to keep another person in the employ of the association will not be enforced because the members are entitled to have the judgment of the director or officer "exercised with a sole regard to the interests

<sup>25</sup> *Consumers' Ice & Coal Co. v. Security Bank & Trust Co.*, 170 Ark. 530, 280 S. W. 677, 684.

<sup>26</sup> *Tefft v. Schaefer*, 136 Wash. 302, 239 P. 837, 1119.

<sup>27</sup> *Tefft v. Schaefer*, 136 Wash. 302, 239 P. 837, 1119.

<sup>28</sup> *Dean v. Shingle*, 198 Cal. 652, 246 P. 1049, 46 A. L. R. 1156.

<sup>29</sup> *In re Webster Loose Leaf Filing Co.*, 240 F. 779. Cf. *Farmers Cooperative Association v. Kotz*, 222 Minn. 153, 23 N. W. 2d 576.

<sup>30</sup> *Smith v. Los Angeles I. & L. Coop. Association*, 78 Cal. 289, 20 P. 677, 12 Am. St. Rep. 53.

<sup>31</sup> *Wardell v. Railroad Co.*, 103 U. S. 651, 26 L. Ed. 509.

<sup>32</sup> *In re Webster Loose Leaf Filing Co.*, 240 F. 779, 785; *Shakespeare v. Smith*, 77 Cal. 638, 20 P. 294, 11 Am. St. Rep. 327.

<sup>33</sup> *Mallory v. Mallory-Wheeler Co.*, 61 Conn. 131, 23 A. 708, 710.

<sup>34</sup> *Wardell v. Railroad Co.*, 103 U. S. 651, 658, 26 L. Ed. 509.

of the company.”<sup>35</sup> Again, it has been held that directors cannot engage in a rival business to the detriment of the corporation.<sup>36</sup> Directors and officers of any corporation, cooperative, or otherwise, may be compelled to account thereto for any gifts, gratuities, or bonuses received by them from persons with whom the association is or may be having business relations.<sup>37</sup> The object of this rule, like the others akin thereto, is to enable corporations to have the “judicial judgment” of their directors and officers free from any suggestion of bias other than the welfare of the corporation.

### Contracts With Directors

The form of cooperative marketing act which has been enacted in many States<sup>38</sup> usually contains the following or similar language relative to directors of associations contracting therewith:

No director, during the term of his office, shall be a party to a contract for profit with the association differing in any way from the business relations accorded regular members or holders of common stock of the association, or others, or differing from terms generally current in that district.

By reason of this provision, any contract of the prohibited type entered into by a director with an association which was formed under a statute containing this provision is invalid. The prohibition is primarily against the director. If a contract of the type prohibited is entered into by a director and is carried out, it would seem that he would be liable to account to the association, its receiver, or its members for any profits or gains resulting therefrom.<sup>39</sup> Any other rule would render the prohibition valueless. It is immaterial that the statute prescribes no penalty or imposes no liability.<sup>40</sup> All directors are conclusively charged with knowledge of the law, so that they cannot plead ignorance thereof.<sup>41</sup> Even though all members of the board of directors of an association, except the contracting director, voted therefor, it would not authorize a prohibited contract, because the directors cannot override the statute but must function within its limits.

### Obligations and Liabilities of Directors

The directors of an association, in directing its affairs, must use care to keep within the powers conferred by its charter and the plan set forth in its bylaws and its marketing contract. Directors and officers of an association are simply agents, and if they exceed their authority or violate the charter, bylaws, or marketing contract of the association legal liability results.<sup>42</sup>

<sup>35</sup> *West v. Camden*, 135 U. S. 507, 514, 10 S. Ct. 838, 34 L. Ed. 254. See also *Timme v. Kopmeier*, 162 Wis. 571, 156 N. W. 961, L. R. A. 1916 D 1114.

<sup>36</sup> *Coleman v. Hanger*, 210 Ky. 309, 275 S. W. 784.

<sup>37</sup> *Keely v. Black*, 90 N. J. Eq. 439, 107 A. 825; *Keystone Guard v. Beaman*, 264 Pa. 397, 107 A. 835; *Holland Furniture Co. v. Knooihuizen*, 197 Mich. 241, 163 N. W. 884.

<sup>38</sup> See sec. 12 of the Bingham Cooperative Marketing Act of Kentucky, p. 304 of Appendix.

<sup>39</sup> *Rutland Electric Light Co. v. Bates*, 68 Vt. 579, 35 A. 480, 54 Am. St. Rep. 904; *Thompson v. Greeley*, 107 Mo. 577, 17 S. W. 962; *Wardell v. Railroad Co.*, 103 U. S. 651, 26 L. Ed. 509.

<sup>40</sup> *Thompson v. Greeley*, 107 Mo. 577, 17 S. W. 962.

<sup>41</sup> *Morrison v. Farmers' Elevator Co.*, 319 Ill. 372, 150 N. E. 330; *Croninger v. Bethel Grove Camp Ground Association*, 156 Ky. 356, 161 S. W. 230.

<sup>42</sup> *Wells, et al. v. Neill, et al.* (*Mississippi Farm Bureau Cotton Association*), 162 Miss. 30, 138 So. 569; *Fergus Falls Woolen Mills Co. v. Boyum*, 136 Minn. 411, 162 N. W. 516, L. R. A. 1918A 919; *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Hoffman v. Farmers' Coop. Shipping Association*, 78 Kan. 561, 97 P. 440. See also *Dome Realty Co. v. Rottenberg*, 285 Mass. 324, 189 N. E. 70.



The office of director is not one for a figurehead. The courts refer to directors as trustees, quasi trustees, fiduciaries, and agents and require them to exercise the most scrupulous good faith toward the corporation and its stockholders.<sup>43</sup> Although directors of an association occupy positions of trust, responsibility, and liability, they are not insurers of the success of the association. They should exercise, however, the same degree of care in directing and supervising the affairs of an association that ordinarily prudent and diligent men would exercise under similar circumstances;<sup>44</sup> that is, reasonable care; and a failure to exercise this degree of care or to be honest and diligent in attending to the affairs of an association may render directors liable at common law to the association, to its receiver if in the hands of a receiver, or under some circumstances to members of the association acting in its behalf.

Directors and officers of an association in the conduct of its affairs should keep within the charter powers of the association. If, by reason of ultra vires acts, an association suffers losses they may be held liable therefor.<sup>45</sup> In Kentucky, directors of a farm bureau were held personally liable on the ground that they had permitted the association to exceed its debt limit.<sup>46</sup> It has been said that "Directors have been held personally liable in an almost infinite variety of cases that are not subject to definite classification, but may properly belong either to negligence or fraud."<sup>47</sup> "The president and board of directors of a corporation are trustees, and act in a fiduciary capacity for its stockholders, and while doing so are forbidden, in equity, to acquire any interest in the property hostile to the interests of the stockholders."<sup>48</sup>

Transactions with a corporation under which its directors obtain advantages for themselves are, broadly speaking, at least voidable. Thus, when directors knowing of the insolvency of a corporation authorized payments to be made by the corporation on notes held by some of them, which notes were barred by the statute of limitations, it was held that this was "a breach of that faith to which the law holds fiduciaries, generally."<sup>49</sup> A suit by a receiver of a farmer cooperative to set aside a chattel mortgage in favor of a former director to secure sums of money he had lent the association and future advances was remitted for a new trial.<sup>50</sup> The appellate court stated that the evidence failed to show that defendant had made arrangements for the mortgage while a director, or any evidence of fraud. It pointed out that the securing of a preference by a general creditor from an insolvent corporation was not, in itself, fraudulent under the laws of Minnesota.

All authorities agree that an association may recover from its directors any losses suffered because of their fraud or dishonesty. Gross negligence on the part of directors which permits other directors to defraud an asso-

<sup>43</sup> *Arkansas Valley Agricultural Society v. Eickholtz*, 45 Kan. 164, 25 P. 613; *L. E. Fosgate Company v. Boston Market Terminal Company*, 275 Mass. 99, 175 N. E. 86.

<sup>44</sup> *Briggs v. Spaulding*, 141 U. S. 132, 11 S. Ct. 924, 35 L. Ed. 662.

<sup>45</sup> *Wells, et al. v. Neill, et al. (Mississippi Farm Bureau Cotton Association)*, 162 Miss. 30, 138 So. 569; *Loomis Machinery Company v. Proctor*, 41 N. M. 519, 71 P. 2d 1029; *Fagerberg v. Phoenix Flour Mills Company*, 50 Ariz. 227, 71 P. 2d 1022.

<sup>46</sup> *Federal Chemical Company v. Paddock*, 264 Ky. 338, 94 S. W. 2d 645.

<sup>47</sup> 2 Thompson on CORPORATIONS, p. 968.

<sup>48</sup> *Center Creek Water & Irrigation Co. v. Lindsay*, 21 Utah 192, 60 P. 559.

<sup>49</sup> *Hein v. Gravelle Farmers' Elevator Company*, 164 Wash. 309, 2 P. 2d 741, 744, 78 A. L. R. 631.

<sup>50</sup> *Farmers Cooperative Association v. Kotz*, 222 Minn. 153, 23 N. W. 2d 576.

ciation will render all of them liable.<sup>51</sup> Inattention on the part of a director may render him liable to his association, at least in those instances in which attention to duty should have prevented the loss of a specific amount.<sup>52</sup> Illness or other sufficient cause will excuse failure to attend board meetings.<sup>53</sup>

In addition to the right of an association to compel a director to account for any profits arising out of a prohibited contract, it appears clear that an association, its receiver, or members acting in its behalf would have the right to recover, from the directors who attempted to authorize such a contract, any losses which the association sustained therefrom.<sup>54</sup>

It should be remembered that, even in the absence of a statute prohibiting directors from entering into unconscionable contracts with their associations, the courts scrutinize such contracts jealously. They may be set aside on slight grounds,<sup>55</sup> even if all the directors of an association except the one receiving the contract voted therefor; and, if a director acted both for himself and for the association, an additional reason for scrutinizing the contract would exist.<sup>56</sup> Such contracts, under common law principles, may be set aside at the election of the association unless of advantage thereto and unless fair and reasonable.<sup>57</sup>

Withheld facts, large profits, suspicious circumstances, or unfavorable terms may afford an association a basis for setting aside such a contract; but, if a contract is made by a director with an association when the association is represented by a majority of the directors, the contract will be upheld if fair and reasonable and if without disadvantage to the association.<sup>58</sup>

The cases are few in which a director, although inattentive to his duties, has been held liable on account of a general collapse of a corporation, if fraud or specific losses traceable to specific transactions are not involved.<sup>59</sup> Probably this is partly because it is difficult to show the amount of the loss suffered in such a case or to show that it is chargeable to the director's neglect. But a director who fails to attend properly to the duties of his office is always confronted by the fact that, generally, he will be held liable for losses resulting from fraud on the part of officers, agents, or other directors of the association; or for specific losses such as one caused by the unlawful expenditure or employment of association funds, if he could reasonably have been expected to prevent the losses by attending to his duties.<sup>60</sup> A director is not liable for losses occasioned by the misconduct of co-

<sup>51</sup> *McGinnis v. Corporation Funding & Finance Co.*, 8 F. 2d 532; *Coddington v. Canaday*, 157 Ind. 243, 61 N. E. 567.

<sup>52</sup> *Bowerman v. Hamner, Receiver*, 250 U. S. 504, 39 S. Ct. 549, 63 L. Ed. 1113; *Besselieu v. Brown*, 177 N. C. 65, 97 S. E. 743, 2 A. L. R. 862.

<sup>53</sup> *Briggs v. Spaulding*, 141 U. S. 132, 11 S. Ct. 924, 35 L. Ed. 662.

<sup>54</sup> *Thompson v. Greeley*, 107 Mo. 577, 17 S. W. 962; *Oakland Bank of Savings v. Wilcox*, 60 Cal. 126; *Citizens Building and Loan Association v. Coriell*, 34 N. J. Eq. 383.

<sup>55</sup> *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587, 23 L. Ed. 328.

<sup>56</sup> *Wainwright v. P. H. & F. M. Roots Co.*, 176 Ind. 682, 97 N. E. 8.

<sup>57</sup> *Wing v. Dillingham*, 239 F. 54, petition for writ of certiorari denied 244 U. S. 654, 37 S. Ct. 652, 61 L. Ed. 1373; *Geddes v. Anaconda Copper Mining Co.*, 254 U. S. 590, 41 S. Ct. 209, 65 L. Ed. 425; *Lembeck & Betz Eagle Brewing Co. v. McAnarney*, 287 F. 927; *Stanton v. Occidental Life Ins. Co.*, 81 Mont. 44, 261 P. 620.

<sup>58</sup> *Nicholson v. Kingery*, 37 Wyo. 299, 261 P. 122; *Stanton v. Occidental Life Ins. Co.*, 81 Mont. 44, 261 P. 620.

<sup>59</sup> *Barnes v. Andrews*, 298 F. 614; but see *Coddington v. Canaday*, 157 Ind. 243, 61 N. E. 567, in which a receiver of a corporation recovered from directors on account of their gross negligence.

<sup>60</sup> *McGinnis v. Corporation Funding & Finance Co.*, 8 F. 2d 532; *Smith v. Cornelius*, 41 W. Va. 59, 23 S. E. 599, 30 L. R. A. 747.

directors when he is without fault.<sup>61</sup> Directors are not liable for losses due to dishonesty of officers or employees unless such directors have failed to exercise reasonable care in the selection of the employees or have retained dishonest officers or employees, after their dishonesty was known.<sup>62</sup>

If the directors or officers of an association misappropriate its funds or engage in other fraudulent conduct that results in losses thereto, their action cannot be condoned; that is, ratified, "except by the unanimous consent of the stockholders; otherwise a majority, or a director who might control a majority vote in the corporation, would be able to rob and despoil it with impunity."<sup>63</sup> If it is claimed that the members of an association have ratified transactions of its directors or officers, it must be shown that the members were advised of all the material facts; because, without knowledge of such facts, there could be no ratification.<sup>64</sup>

Primarily, the right to bring suit against directors for an accounting, or to annul a contract voidable because a director had an unlawful personal interest is in the corporation, or in its receiver if the corporation is in the hands of a receiver; but members of the corporation may sue the directors under such circumstances, if the directors then in control of the association are themselves the wrongdoers, as it would be folly to expect directors to institute and properly conduct a suit against themselves.<sup>65</sup> The general rule is that no other persons can institute such suits. It has been held that farmers who were eligible for membership in a rural electric cooperative, but who were not members thereof, had no legal standing to object to action taken by its board of directors, since the legal rights of these farmers were not affected thereby.<sup>66</sup>

Can directors of an association ever be liable personally to others? If directors cause or are responsible for the association's violation of the legal rights of others—for instance, by the misapplication of funds,<sup>67</sup> by fraud, trespass, coercion, or deceit—they are personally liable to such persons;<sup>68</sup> and the fact that the association may also be liable does not alter the situation. The doctrine is simply an application of the general rule that agents are liable to third persons for any invasion of their legal rights, regardless of the liability of their principals. The liability of directors who sign the notes of an association is discussed under the heading "Promissory Notes" (see p. 180).

While the board of directors of a cooperative is normally vested with full authority to conduct and manage the business of the association, in some States statutes have been enacted requiring consent of the members

<sup>61</sup> *Fisher v. Graves*, 80 F. 590.

<sup>62</sup> *Bates v. Dresser*, 251 U. S. 524, 40 S. Ct. 247, 64 L. Ed. 388.

<sup>63</sup> *Ford v. Ford Roofing Products Co.*, 285 S. W. 538, 541 (Mo. App.). See also *Monterey Water Company v. Voorhees*, 45 Ariz. 338, 43 P. 2d 196.

<sup>64</sup> *Mallory v. Mallory-Wheeler Co.*, 61 Conn. 131, 23 A. 708; *Lindeke v. Scott County Cooperative Company*, 126 Minn. 464, 148 N. W. 459.

<sup>65</sup> *Browne v. Hammett*, 133 S. C. 446, 131 S. E. 612; *Morton v. Morton Realty Co.*, 41 Idaho 729, 241 P. 1014; *Rural Credit Subscribers' Association v. Jett*, 205 Ky. 604, 266 S. W. 240; *Loftus v. Farmers' Shipping Association*, 8 S. D. 201, 65 N. W. 1076; *Pencille v. State Farmers' Mutual Hail Insurance Company*, 74 Minn. 67, 76 N. W. 1026, 73 Am. St. Rep. 326.

<sup>66</sup> *Bailey v. Carolina Power & Light Company*, 212 N. C. 768, 195 S. E. 64.

<sup>67</sup> *Cone v. United Fruit Growers' Association*, 171 N. C. 530, 88 S. E. 860. See also *Lewis v. Council*, 291 F. 148; *Dome Realty Co. v. Rottenberg*, 285 Mass. 324, 189 N. E. 70.

<sup>68</sup> *Frontier Milling & Elevator Co. v. Roy White Coop. Mercantile Co.*, 25 Idaho 478, 138 P. 825; *Springman Paper Products Co. v. Detroit Ignition Co.*, 236 Mich. 90, 210 N. W. 222; *Scott v. Shook*, 80 Colo. 40, 249 P. 259, 47 A. L. R. 1108; *Houston v. Thornton*, 122 N. C. 365, 29 S. E. 827, 65 Am. St. Rep. 699.



or stockholders to certain corporate acts. For instance, the consent of a certain percentage of the members or stockholders to the giving of a mortgage on substantially all the property of an association is required in some States.<sup>69</sup> Likewise, in certain States there may not be a sale of all the assets of a corporation unless authorized or approved by a vote of the holders of a prescribed percentage of the outstanding shares of capital stock.<sup>70</sup> Statutes of this kind have been held applicable to mortgages.<sup>71</sup>

In some States there are statutory provisions that, under certain conditions, the board of directors of an association must refer to the membership any matter upon which it has acted. For instance, the Cooperative Marketing Act of South Dakota provides that <sup>72</sup>—

Upon demand of forty percent of the entire board of directors any matter that has been approved or passed by the board must be referred to the entire membership or the stockholders for decision at the next special or regular meeting: *Provided, however, That a special meeting may be called for the purpose.*

In an Ohio case, in which an association began operations before the required amount of stock had been subscribed, the directors were held liable as partners.<sup>73</sup>

A cooperative statute <sup>74</sup> of Indiana contains a provision reading as follows:

In the absence of any provision in the bylaws of an association after March 1, 1940, authorizing the incurring of indebtedness to the association by any director, manager, officer or employee the extension of credit to any such individual to any amount exceeding one-half his monthly salary and/or three-fourths of the par value of stock owned by such individual shall be deemed to be forbidden by such bylaws. Such value of stock shall be computed as including any credit for the purchase of stock not yet actually issued to such individual.

No reason is apparent why directors of a cooperative could not under certain circumstances be held liable for losses arising from a violation of the foregoing statutory provision.

### **Additional Liabilities Imposed by Statute**

The discussion so far has been based upon the common law, that is, the rule applicable independent of any statutes. But do the State constitutions and statutes impose liabilities upon directors of cooperatives in common with other corporate directors? Yes; many, if not all, of the States have provisions in their statutes or constitutions which impose duties and liabilities upon the directors <sup>75</sup> or officers of corporations, or both.<sup>76</sup> Generally speaking, these provisions are applicable to the directors and officers of cooperatives.

As illustrating the liability under statutes of the directors of cooperatives, a case passed upon by the Supreme Court of Montana involving a cooperative is of interest. In this case the directors were held liable

<sup>69</sup> *Shapiro v. Peoples Cooperative Society, Inc.*, 125 Misc. 839, 211 N. Y. S. 468; 19 C. J. S. 654.

<sup>70</sup> *Michigan Wolverine Student Cooperative, Inc. v. Wm. Goodyear & Co.*, 314 Mich. 590, 22 N. W. 2d 884.

<sup>71</sup> *Clark v. Pargeter*, 142 Kan. 781, 52 P. 2d 617; *McDonald v. First National Bank of Attleboro*, 70 F. 2d 69.

<sup>72</sup> S. D. Code of 1939, sec. 4.1617. Cf. Tenn. Code Ann., sec. 3815.

<sup>73</sup> *Farmers' Cooperative Trust Company v. Floyd*, 47 Ohio St. 525, 26 N. E. 110, 12 L. R. A. 346.

<sup>74</sup> Ind. Stats. Ann., sec. 15-1611 (j).

<sup>75</sup> *Farmers' Cooperative Trust Company v. Floyd*, 47 Ohio St. 525, 26 N. E. 110, 12 L. R. A. 346.

<sup>76</sup> *Rice v. Madelia Farmers' Warehouse Co.*, 87 Minn. 398, 92 N. W. 225.

to creditors because they failed to file a report showing the condition of the association as required by a Montana statute.<sup>77</sup>

The Constitution of California until changed in 1930 provided that—

The directors or trustees of corporations and joint-stock associations shall be jointly and severally liable to the creditors and stockholders for all moneys embezzled or misappropriated by the officers of such corporation or joint-stock association, during the term of office of such director or trustee.

In a case <sup>78</sup> which was passed upon by the Supreme Court of California, an officer of a corporation was held liable to the trustees in bankruptcy of the corporation because he sold an automobile he owned to the corporation, thus acting in the dual capacity of buyer and seller without disclosing the facts to the corporation.

Directors of cooperatives should ascertain the duties and liabilities imposed upon them by State constitutions and statutes and should govern their actions accordingly. It is not sufficient, ordinarily, simply to examine the cooperative statutes of the State; the general statutes of the State relative to directors should also be carefully examined. Under many of the corporation statutes the directors of a corporation at the time of its dissolution are trustees for its creditors.<sup>79</sup>

### Executive Committee

Although the laws generally provide that the business of an association shall be conducted, managed, and controlled by a board of directors, many cooperatives provide for an executive committee to function with respect to certain aspects of its affairs. The general rule is that the board of directors of a corporation may delegate ministerial matters to an executive committee, but generally it is held that a board of directors may not delegate its own discretionary power.<sup>80</sup>

In a few States it is held that the directors have the power without statutory authority to delegate to officers, agents, or executive committees the power to transact not only ordinary and routine business but business requiring the highest degree of judgment and discretion.<sup>81</sup>

The rule just stated is not the general one. In all States, after the board of directors of an association has determined upon a certain policy or course, it may have such policy or course carried out by an executive committee or by any other means deemed advisable; but generally the initiation of fundamental policies should be done by the board of directors. Many of the cooperative statutes deal expressly with the matter of executive committees, and such statutory provisions should be followed. The general rules pertaining to boards of directors, such as those concerning quorums, apply to executive committees.

### Minutes of Meetings

The minutes of meetings of the board of directors of an association should tell the story of the board's action on association business. Like-

<sup>77</sup> *Anderson v. Equity Coop. Association*, 67 Mont. 291, 215 P. 802; *Githers v. Clarke*, 158 Pa. 616, 28 A. 232.

<sup>78</sup> *Dean v. Shingle*, 198 Cal. 652, 246 P. 1049, 46 A. L. R. 1156.

<sup>79</sup> *Kansas Wheat Growers' Association v. Markley*, 132 Kan. 156, 294 P. 885.

<sup>80</sup> *Ames v. Goldfield Merger Mines Co.*, 227 F. 292.

<sup>81</sup> *Jones v. Williams*, 139 Mo. 1, 39 S. W. 486, 40 S. W. 353, 61 Am. St. Rep. 436, 37 L. R. A. 682; *Haldeman v. Haldeman*, 176 Ky. 635, 197 S. W. 376. See also *United States v. Union Pacific Railroad Company*, 226 U. S. 470, 33 S. Ct. 162, 57 L. Ed. 306.

wise, the minutes of meetings of association members should tell the story of the action they have taken respecting its affairs. In the absence of charter or statutory provisions it is not necessary that the acts of an association, its officers, or its board of directors be evidenced by any writing or record not necessary in the case of an individual. Although generally, from a strictly legal standpoint, it is not necessary that minutes of meetings of an association or of its board of directors be kept, it is highly important that this be done. If no minutes are made of the action of the board of directors, oral testimony is admissible to show the action taken in the event a question on this point should arise in the course of a lawsuit.<sup>82</sup>

The minutes of a meeting should show the date and hour when it was held. The statutes of many States expressly authorize the holding of board meetings outside the State in which the corporation was incorporated. There is a serious question whether action taken by a board of directors at a meeting outside such State is legally binding on third persons and the corporation in the absence of a statutory or charter provision authorizing the same.<sup>83</sup>

The action taken by directors of an association at a meeting of the board should be recorded in the minutes of the board. The action taken by members of an association in the meetings thereof should be recorded in the minutes of the association. The directors of an association possess all the corporate powers of the association not specifically reserved to the members. The directors of an association should direct and manage its affairs within the scope of the powers conferred by the charter, subject to any restrictions contained in its bylaws or marketing contracts. The execution of the orders or the carrying out of the policies fixed by the board of directors is done by the officers and employees thereof. Officers of an association by reason of their offices, or employees by reason of their employment, regardless of their rank, have no authority to bind the association unless such authority has been conferred upon them otherwise than by their election to office or by their employment.

Authority for the action of the officers of an association or its employees should be found in the action of the board of directors. In this lies the chief importance of minutes of boards of directors. If no minutes are kept of board meetings, oral testimony is admissible to show action taken; on the other hand, if minutes are kept, such minutes are regarded as the best evidence of action taken by the board of directors in the absence of evidence of fraud impeaching the minutes.<sup>84</sup>

All courts, in the absence of fraud impeaching the minutes, regard the minutes at least as prima facie evidence of the action taken by the board of directors.<sup>85</sup>

Before loaning money to an association, banks frequently, if not generally, inquire if the officers have been authorized by the board of directors to borrow money. Frequently a copy of the minutes of the board of direc-

<sup>82</sup> *Robson v. C. E. Fenniman Co.*, 83 N. J. Law 453, 85 A. 356; *Whitlock v. Alexander*, 160 N. C. 465, 76 S. E. 538; *Hughes Mfg. & Lumber Co. v. Wilcox*, 13 Cal. App. 22, 108 P. 871; *Iowa Drug Co. v. Souers*, 139 Iowa 72, 117 N. W. 300, 19 L. R. A. (N. S.) 115; *Traxler v. Minneapolis Cedar & Lumber Co.*, 128 Minn. 295, 150 N. W. 914.

<sup>83</sup> Ballantine's *MANUAL OF CORPORATION LAW AND PRACTICE*, sec. 102; 2 *Fletcher CYCLOPEDIA CORPORATIONS*, Perm. Ed., sec. 403.

<sup>84</sup> *German Ins. Co. of Freeport, Ill., v. Independent School District of Milford, Dickinson County, Iowa*, 80 F. 366; *Hawkshaw v. Supreme Lodge of Knights of Honor*, 29 F. 770.

<sup>85</sup> 14 C. J. 376, 377.



tors covering the matter is requested. This is done to see if the board has authorized the proposed action or has imposed any restrictions with reference thereto, for it will be constantly remembered that an association may act only through agents and that persons dealing with an agent act at their own risk. If it should turn out that the agent, whether he be president, secretary, or manager, was not authorized to enter into the contract in question on behalf of the association or to engage in any other transaction as its representative, the association is not bound in the absence of estoppel or ratification.<sup>86</sup> On the other hand, if the minutes of a meeting of the board of directors show that the officer was authorized to enter into a certain transaction, such minutes are virtually conclusive on the subject in the absence of fraud, and protect the officer representing the association in the transaction as well as the other party thereto. The failure to record a resolution of a board of directors does not affect its validity.<sup>87</sup>

While a corporation's books and records are evidence to prove its own acts, they are not competent evidence against third persons to prove contracts with them in the absence of proof that they knew and assented thereto.<sup>88</sup>

## Officers and Employees

**B**ROADLY stated, all employees and representatives of an association are agents thereof.

Officers of an association are agents<sup>89</sup> and the general rules of agency apply to them. The officers of an association, or certain of them, under the statutes, are usually required to be elected by the directors from among their own number.<sup>90</sup> On the other hand, unless required by law, the charter, or the bylaws, the officers of a corporation need be neither directors nor members nor stockholders thereof.<sup>91</sup>

The legality of the election of an officer may not be attacked collaterally.<sup>92</sup>

Reasonable care should be exercised in the selection of employees because failure to do so may be a basis for charging an association with liability.<sup>93</sup>

The manager of a cooperative, like its officers and directors, should invariably avoid situations where it might even remotely appear that he had interests adverse to those of the association. An association may recover money made by a manager from unauthorized undisclosed business transactions involving or affecting the association, even though the association suffers no loss therefrom. And in the case<sup>94</sup> cited below, the surety was also held liable on the faithful performance bond of the manager who engaged in such transactions.

<sup>86</sup> *David Stott Flour Mills, Inc. v. Saginaw County Farm Bureau*, 237 Mich. 657, 213 N. W. 147; *Farmers' Coop. Mercantile Co. v. Shultz*, 113 Neb. 801, 205 N. W. 288.

<sup>87</sup> *Handley v. Stutz*, 139 U. S. 417, 11 S. Ct. 530, 35 L. Ed. 227.

<sup>88</sup> *Oregon and C. R. Co. v. Grubisich*, 206 F. 577.

<sup>89</sup> *Allen v. Cochran*, 160 La. 425, 107 So. 292, 50 A. L. R. 459.

<sup>90</sup> See sec. 13 of the Bingham Cooperative Marketing Act of Kentucky, p. 304 of Appendix.

<sup>91</sup> *Wight v. Springfield & New London Railroad Co.*, 117 Mass. 226, 19 Am. Rep. 412.

<sup>92</sup> *Bruun v. Cook*, 280 Mich. 484, 273 N. W. 774.

<sup>93</sup> *Ellsworth v. Franklin County Agricultural Society*, 99 App. Div. 119, 91 N. Y. S. 1040.

<sup>94</sup> *Goodhue Farmers' Warehouse Co. v. Davis*, 81 Minn. 210, 83 N. W. 531. See also *Hoffman v. Farmers' Coop. Shipping Association*, 78 Kan. 561, 97 P. 440; 7 R. C. L., sec. 426.

## Terms and Compensation

Officers, like directors, barring resignation or expulsion, continue in office after the expiration of the terms for which elected until the election and qualification of their successors, with all the rights and responsibilities of such officers.<sup>95</sup>

Presumptively, officers, as well as directors, of an association serve without compensation while performing the regular duties of their offices;<sup>96</sup> and generally these officers are entitled to no compensation for performing the duties of their offices unless provision therefor was made prior to assuming their duties.

In a North Carolina case, the president of the North Carolina Agricultural Credit Corporation sought to recover compensation for work performed when he was president of the corporation. The court held that he was not entitled to any compensation for the services rendered by him as president because no express contract of employment providing for compensation had been made prior to the rendition of the services.<sup>97</sup>

Officers, like directors, do not have the power to fix their own salaries. If their salaries or the method of fixing their salaries is not prescribed in the statute or bylaws or by the members, they may be fixed, or contracts providing for compensation may be made, as a general rule, only prior to the rendition of services, by a quorum of directors in a board meeting, who are not officers of the association or in any other way disqualified.<sup>98</sup>

## Powers of Officers

Neither the president nor any other agent of an association has any inherent power by virtue of his office or employment to enter into business transactions on its behalf,<sup>99</sup> and unless authority to do so is conferred upon officers or other employees it is not possessed by them. For instance, unless specially authorized to do so, an officer of an association could not accept payment of a note calling for payment in money, except by the receipt of money and then only by receiving the full sum due.<sup>1</sup> In this connection, it is said:

A corporation is bound by the act of an officer or agent only to the extent that the power to do the act has been conferred upon such officer or agent expressly by the charter, bylaws, or corporate action of its stockholders or board of directors, or can be implied from the powers expressly conferred, or which are incidental thereto, or where the act is within the apparent powers which the corporation has caused those with whom its officers or agents have dealt to believe it has conferred upon them.<sup>2</sup>

<sup>95</sup> *Weil v. Defenbach*, 36 Idaho 37, 208 P. 1025; *Stanton v. Occidental Life Ins. Co.*, 81 Mont. 44, 261 P. 620.

<sup>96</sup> *First National Bank of Allen v. Daugherty*, 122 Okla. 47, 250 P. 796; *Navco Hardwood Co. v. Bass*, 214 Ala. 553, 108 So. 452.

<sup>97</sup> *North Carolina Agricultural Credit Corporation v. Boushall*, 193 N. C. 605, 137 S. E. 721; *Goodin v. Dixie-Portland Cement Co.*, 79 W. Va. 83, 90 S. E. 544, L. R. A. 1917F 308; *Baltimore & Jamaica Trading Co. v. Dinning*, 141 Md. 318, 118 A. 801.

<sup>98</sup> *Briggs v. Gilbert Grocery Co.*, 116 Ohio 343, 156 N. E. 494; *Schaffhauser v. Arnholt & Schaefer Brewing Co.*, 218 Pa. 298, 67 A. 417, 11 Ann. Cas. 772.

<sup>99</sup> *Sterling v. Trust Co. of Norfolk*, 149 Va. 867, 141 S. E. 856.

<sup>1</sup> *Stanton v. Occidental Life Ins. Co.*, 81 Mont. 44, 261 P. 620.

<sup>2</sup> *Aerial League of America v. Aircraft Fireproofing Corporation*, 97 N. J. L. 530, 117 A. 704. See also *Merchants' National Bank of Peoria v. Nichols & Shepard Company*, 223 Ill. 41, 79 N. E. 38, 7 L. R. A. (N. S.) 752; *Peasley v. Producers' Market Co.*, 86 Cal. App. 577, 261 P. 733; *David Stott Flour Mills, Inc. v. Saginaw County Farm Bureau*, 237 Mich. 657, 213 N. W. 147.

In the case last cited, involving the Saginaw County Farm Bureau, it was held that that organization was not liable for flour ordered in its name by a county agent who had not been authorized by the board of directors to order the flour.

Owing to the foregoing rule, officers of an association, its manager or any other employee should be authorized by the board of directors to act before attempting to enter into transactions; and persons dealing with an association should ascertain that its representatives are authorized to enter into contracts or transactions of the type under consideration.

A change, or changes, in the membership of a board of directors does not of itself abrogate authority previously conferred by the board of directors on officers of a corporation.<sup>3</sup> Likewise, when a transaction has been approved by officers having authority so to do, the directors may not, by subsequently withdrawing the authority from the officers, relieve the corporation of liability and disaffirm the contract.<sup>4</sup>

The general rule is that if a corporation has received the benefit of an unauthorized contract, it is bound thereby.<sup>5</sup>

If any agent of an association enters into a contract that has not been authorized, but which is within the scope of the association's powers, the association may ratify the contract if it acts before the opposing party repudiates it. After such ratification, it becomes as binding as though previously authorized.<sup>6</sup> However, if an association's agents enter into a contract which is in violation of the law, such contract is invalid and the cooperative cannot recover on it.<sup>7</sup>

Insofar as third persons are concerned, generally speaking, a manager or an officer of an association has just as much authority as the association has represented that he possesses.<sup>8</sup> Under this principle associations have been held liable on account of the acts of managers and officers which were not specifically authorized.<sup>9</sup> If a manager or an officer of an association is exercising more authority than its board of directors deems he should exercise, the board should prescribe the limits of his authority and persons who have previously dealt with the association, such as banks, should be specifically advised of the limits of his authority.<sup>10</sup>

An employee of an association used association funds to finance enterprises of his own in violation of the charter and bylaws of the association, but with the approval of some of the individual members of its board of directors. When the employee brought suit for his salary, the associa-

<sup>3</sup> *Kidd v. New Hampshire Traction Company*, 74 N. H. 160, 66 A. 127.

<sup>4</sup> *Perryman & Company v. Farmers' Union Ginning and Manufacturing Company*, 167 Ala. 414, 52 So. 644.

<sup>5</sup> *Hamaker v. Fulton Farmers' Association*, 271 Pa. 465, 114 A. 627.

<sup>6</sup> *Stone v. Walker*, 201 Ala. 130, 77 So. 554, L. R. A. 1918C 839; *Commissioners of Lewes v. Breakwater Fisheries Co.*, 13 Del. Ch. 234, 117 A. 823, affirmed in 14 Del. Ch. 433, 128 A. 920.

<sup>7</sup> *United States v. Dake*, 42 F. Supp. 833.

<sup>8</sup> *Producers' Fruit Company of California v. Goddard*, 75 Cal. App. 737, 243 P. 686.

<sup>9</sup> *Betts v. Southern California Fruit Exchange*, 144 Cal. 402, 77 P. 993; *Federal Chemical Company v. Farmers Produce Exchange*, 123 S. W. 2d 612 (Mo. App.); *Ely, Salyards & Co. v. Farmers' Elevator Company of Nohle*, 69 Mont. 265, 221 P. 522; *Cooperative Stores Company v. Marianna Hotel Company*, 128 Ark. 196, 193 S. W. 529; *Hopkins v. Paradise Heights Fruit Growers' Association*, 58 Mont. 404, 193 P. 389.

<sup>10</sup> *Fidelity & Deposit Company of Maryland v. Merchants National Bank*, 223 Iowa 446, 273 N. W. 141.



tion was able to maintain a defense to the extent of the funds so used.<sup>11</sup>

A manager of a corporation issued a corporation check to pay a private debt. The creditor of the manager was held to have been put on notice of the situation, and the corporation was allowed to recover from the creditor.<sup>12</sup>

Officers of an association should constantly bear in mind that money furnished for a specific purpose may not lawfully be used by them for other purposes.<sup>13</sup>

Where the bylaws of an association required written notice of a member's withdrawal to be given at a specified time, the manager of the association could not waive such bylaws unless authorized to do so by the association.<sup>14</sup>

Notice to officers of matters concerning the association or knowledge by them of facts affecting its interests will generally be deemed to be notice to, or knowledge of, the association, but this is ordinarily not true if the officer is dealing personally with the association.<sup>15</sup>

Officers usually may not enter into transactions with an association in which they attempt to act both for themselves and the association. Transactions entered into in this manner may ordinarily be repudiated by an association. The restrictions applicable to directors dealing with an association apply to officers, and for information on this subject the reader is referred to the section on "Conflicting Personal Interests."

The fidelity and good faith that the law demands every agent have toward his principal is illustrated in a Massachusetts case<sup>16</sup> in which a farm manager made purchases of farm supplies from a cooperative in which he was a stockholder. By reason of such purchases he received "a commission of seven shares of stock from that corporation." He did not inform his employer of the receipt of these shares of stock. The court said:

They constituted a "secret" profit for which he never accounted to the defendant. As the plaintiff was guilty of taking a bonus in the form of shares of stock in a corporation in which he was a stockholder, by reason of his purchases from that corporation on behalf of his employer, he is barred from the recovery of salary or wages.

A corporation, it has been held, cannot condone the fraud or wrongdoing of an officer or director except by unanimous consent of the stockholders or members.<sup>17</sup>

It should be borne in mind that an association may be estopped from denying the truth of statements made by one of its officers.<sup>18</sup>

<sup>11</sup> *South Texas Cotton Cooperative Association v. Burgess*, 103 S. W. 2d 1095 (Tex. Civ. App.).

<sup>12</sup> *Farmers' Market v. Austin*, 118 Wash. 103, 203 P. 42.

<sup>13</sup> *Speh v. Bullard*, 90 F. 2d 227.

<sup>14</sup> *Placentia Coop. Orange Growers' Association v. Henning*, 118 Cal. App. 487, 5 P. 2d 444.

<sup>15</sup> *Bartlett v. McCallister*, 316 Mo. 129, 289 S. W. 814; *Knobley Mountain Orchard Co. v. People's Bank of Keyser*, 99 W. Va. 438, 129 S. E. 474, 48 A. L. R. 459; *York Livestock Commission Company v. Northwestern Livestock Commission Company*, 136 Neb. 716, 287 N. W. 94.

<sup>16</sup> *Raymond v. Davies*, 293 Mass. 117, 199 N. E. 321, 323, 102 A. L. R. 1112. See note in 102 A. L. R. 1115.

<sup>17</sup> *Ford v. Ford Roofing Products Co.*, 285 S. W. 538 (Mo. App.). See also *Tenison v. Patton*, 95 Tex. 284, 67 S. W. 92.

<sup>18</sup> *Seaman v. Big Horn Canal Association*, 29 Wyo. 391, 213 P. 938. See also *Pacific Wool Growers v. Draper & Co.*, 158 Ore. 1, 73 P. 2d 1391; *Hill v. Associated Almond Growers of Paso Robles*, 90 Cal. App. 291, 265 P. 873.

In the signing of contracts or other documents pertaining to the business of an association, an officer should sign them in such a way as to show that he is acting in his official rather than in his personal capacity. This is usually done by signing the name of the association "by" the officer in question, followed by his title. Of course, an association may not make an affidavit as this may be done only by a person acting on its behalf.<sup>19</sup>

## Removal of Directors, Officers, and Agents

Many of the cooperative statutes contain provisions that deal with the matter of removing directors and officers before the expiration of their terms.<sup>20</sup> Associations formed under these statutes should follow these provisions.

At common law the general rule permits the board of directors to remove officers and other agents elected or chosen by them or under their authority without a hearing, although it is advisable to hold a hearing. Liability on the part of the association on account of such action would depend on whether cause for removal existed.<sup>21</sup> On the other hand, ordinarily, directors and officers elected by the members may be removed by the members before the expiration of their terms only for cause and after notice and a hearing.<sup>22</sup>

When a director is required to be a stockholder it has been held that he loses the office when he ceases to be a stockholder.<sup>23</sup>

In a case in which officers of an association were "elected" by votes cast by proxies, when the bylaws of the organization did not provide for proxy voting, members of the association enjoined the officers from acting as such.<sup>24</sup>

In a case which resulted from the discharge of an agent by a cooperative organization, it was said: <sup>25</sup>

Even though an agency is for a definite term, the principal has a right to revoke it before the expiration of the term, without incurring liability for damages, because of the agent's failure faithfully to perform his express or implied undertakings as agent.

The default on the part of an agent which will justify the revocation of the contract is not confined to his dealings with the principal. This right of revocation for cause is held to extend to moral delinquencies, which are calculated to affect injuriously the agent's reputation.

If the period for which an employee is employed is not specified, the general rule is that the employment is terminable at the will of either party, but the usages prevailing in the particular business and all the facts and circumstances may justify a different conclusion.<sup>26</sup>

<sup>19</sup> *Agricultural Bond & Credit Corporation v. Courtenay Farmers' Cooperative Association*, 64 N. D. 253, 251 N. W. 881.

<sup>20</sup> See sec. 15 of the Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>21</sup> *Brindley v. Walker*, 221 Pa. 287, 70 A. 794, 23 L. R. A. (N. S.) 1293; 14a C. J. 74.

<sup>22</sup> *Alliance Coop. Ins. Co. v. Gasche*, 93 Kan. 147, 142 P. 882; *Brindley v. Walker*, 221 Pa. 287, 70 A. 794, 23 L. R. A. (N. S.) 1293; *State ex rel. Koski v. Kylmanen*, 178 Minn. 164, 226 N. W. 401; 14a C. J. 74.

<sup>23</sup> *Chemical National Bank of New York v. Colwell*, 132 N. Y. 250, 30 N. E. 644.

<sup>24</sup> *Pohle v. Rhode Island Food Dealers Association*, 63 R. I. 91, 7 A. 2d 267.

<sup>25</sup> *Coates v. Eastern States Farmers' Exchange*, 99 Vt. 170, 130 A. 709, 712.

<sup>26</sup> *Putnam v. Producers' Live Stock Marketing Association*, 256 Ky. 196, 75 S. W. 2d 1075.

## Liability for Wrongs Done

If an officer, while acting within the apparent scope of the authority conferred upon him by the association, perpetrates a fraud on an innocent third party or otherwise violates the right of such party, the association probably would be liable although the officer was really acting for his own benefit.<sup>27</sup>

Also, the officers of an association are liable for wrongs committed by them through the instrumentality of an association, and they may be held liable for any damage which they cause to third persons through the violation of their legal rights.<sup>28</sup>

The question sometimes arises as to whether a particular individual is an employee of a cooperative or an independent contractor. An association will not, of course, be held liable for the acts of an independent contractor. In a Wisconsin case,<sup>29</sup> the facts were found to warrant a conclusion that the individual involved was the association's employee and, accordingly, the association was held liable for injuries which he had caused. In a case involving the same question in relation to liability for unemployment taxes, the individual also was held to be an employee.<sup>30</sup>

The statutes of some States impose duties and responsibilities on officers of corporations or associations. For instance, in many States officers are required by statute to file certain reports. Associations should ascertain the duties and responsibilities placed on officers of cooperatives by the statutes or constitution of the State in which the organization is formed, and officers thereof should govern their actions accordingly.

## Meetings of Associations

MANY of the statutes under which cooperatives are formed contain provisions with respect to the holding of meetings. Frequently such statutes require that one meeting be held each year and permit the holding of special meetings at any time. These statutory provisions should be followed. In the absence of a controlling provision in the statute or charter on the subject, an association may adopt bylaws to govern the calling of meetings and, of course, in any case the subject may be covered in bylaws that are consistent with the statute under which the association is formed and with its charter.

When the statute so provides, meetings of an association may be held outside of the State, but in the absence of a statutory or charter provision

<sup>27</sup> *Fidelity & Deposit Company of Maryland v. Merchants National Bank*, 223 Iowa 446, 273 N. W. 141; *Hill v. Associated Almond Growers of Paso Robles*, 90 Cal. App. 291, 265 P. 873; *Hamaker v. Fulton Farmers' Association*, 271 Pa. 465, 114 A. 627; *Engen v. Merchants' & Mfrs. State Bank*, 164 Minn. 293, 204 N. W. 963, 43 A. L. R. 610.

<sup>28</sup> *California Grape Control Board, Ltd. v. Boothe Fruit Company*, 220 Cal. 279, 29 P. 2d 857; *Scott v. Shook*, 80 Colo. 40, 249 P. 259; *Springman Paper Products Co. v. Detroit Ignition Co.*, 236 Mich. 90, 210 N. W. 222; *Tyler v. Savage*, 143 U. S. 79, 12 S. Ct. 340, 36 L. Ed. 82; *Jamestown Iron & Metal Co., Inc. v. Knofsky*, 291 Pa. 60, 139 A. 611; *Hilgendorf v. Schuman*, 232 Wis. 625, 288 N. W. 184.

<sup>29</sup> *Green Valley Cooperative Dairy Co. v. Industrial Commission*, 250 Wis. 502, 27 N. W. 2d 454.

<sup>30</sup> *Rochester Dairy Co. v. Christgau*, 217 Minn. 460, 14 N. W. 2d 780. See also *Meredith Pub. Co. v. Iowa Employment Security Commission*, 232 Iowa 666, 6 N. W. 2d 6.



authorizing this, it is safer to hold such meetings in the State of incorporation.<sup>31</sup>

It has been held that nonprofit nonstock corporations operating with a membership in different States may hold meetings of the members outside the State of incorporation even without a statutory provision authorizing the same.<sup>32</sup>

Unless a statute specifies how notices of meetings shall be given the bylaws may state the method to be followed, such as by publication in certain newspapers or by mailing notices a certain number of days prior to the meeting. "It is not within the province of the courts to declare any form of notice of a shareholders' meeting insufficient, if it complies with the charter and bylaws of the corporation, unless there is some specific statutory provision to the contrary."<sup>33</sup> But where neither the statute, charter, nor bylaws authorized the giving of a notice of a special meeting which did not state the business to be considered at the meeting, such a notice was held invalid.<sup>34</sup>

Generally, a bylaw providing for the giving of notices of meetings by mail should be so worded that the effectiveness of the notice will depend on its mailing rather than on its receipt.

With respect to the general conduct of meetings the fundamental rule is that the majority controls.<sup>35</sup> A presiding officer, for instance, who refuses to allow the majority to express its will may be removed and another chosen in his stead.

Reasonable election rules may be set forth in the bylaws of an association and if the bylaws authorize its directors to determine the election rules, a rule adopted by the directors providing that if a man votes twice only the ballot first cast shall be counted, is valid.<sup>36</sup>

Where a bylaw provided that all nominations for the office of director were to be made by shareholders at the regular meeting of directors in the month preceding the annual meeting of shareholders, it was held that this did not prevent the stockholders from electing persons as directors who had not been so nominated.<sup>37</sup>

As a general rule, a meeting at which less than a quorum is present may not be lawfully adjourned to meet at a subsequent date unless the statute or the bylaws of an association so authorize.<sup>38</sup> If a quorum is present at a meeting it may be adjourned to meet at a later date and the subsequent meeting is regarded simply as a continuation of the previous meeting.<sup>39</sup>

## Quorum for Meetings of Members

An association may adopt bylaws dealing with the procedure to be followed in the conduct of meetings and specifying the number of members

<sup>31</sup> *Handley v. Stutz*, 139 U. S. 417, 11 S. Ct. 530, 35 L. Ed. 227; Ballantine's MANUAL OF CORPORATION LAW AND PRACTICE, sec. 168; 5 Fletcher CYCLOPEDIA CORPORATIONS, Perm. Ed., sec. 2003.

<sup>32</sup> *In re George*, 199 N. Y. S. 557, 205 App. Div. 234, affirmed in *George v. Holstein-Friesian Association of America*, 238 N. Y. 513, 144 N. E. 776.

<sup>33</sup> *Citrus Growers' Dev. Association v. Salt River V. W. Users' Association*, 34 Ariz. 105, 268 P. 773, 777.

<sup>34</sup> *Noremac, Inc. v. Centre Hill Court*, 164 Va. 151, 178 S. E. 877.

<sup>35</sup> *American Aberdeen-Angus Breeders' Association v. Fullerton*, 325 Ill. 323, 156 N. E. 314.

<sup>36</sup> *Davis v. S. C. Cotton Growers' Coop. Association*, 127 S. C. 353, 121 S. E. 260.

<sup>37</sup> *Commonwealth ex rel. Grabert v. Markey*, 325 Pa. 433, 190 A. 892.

<sup>38</sup> *Noremac, Inc. v. Centre Hill Court*, 164 Va. 151, 178 S. E. 877.

<sup>39</sup> *Sagness v. Farmers' Cooperative Creamery Company*, 67 S. D. 379, 293 N. W. 365.

required for a quorum. When the bylaws specify the number of members necessary to constitute a quorum, a valid meeting cannot be held unless the number of members specified is present at the time each proposition is voted upon.<sup>40</sup>

If the law of the State in which an association is formed specifies the number of members that must attend a meeting in order that there may be a quorum, this is controlling, and a bylaw in conflict therewith is void.<sup>41</sup>

At common law and in the absence of a statutory, charter, or bylaw provision changing the rule, the members who attend a meeting of an association constitute a quorum for the conduct of business. In other words, at common law those who come constitute a valid meeting for the transaction of business.<sup>42</sup>

If the bylaws require, say a two-thirds vote of members present to carry a proposition, members present but not voting cannot be counted as voting for either side.<sup>43</sup>

### Voting Unit

At common law a stockholder or member of an association has but one vote on questions coming before meetings of stockholders or members irrespective of the number of shares.<sup>44</sup> In a case decided by the Supreme Court of the United States it was said:

Usually a stockholder is a member of the company and as such has a right to vote, but it does not necessarily follow that the right increases with the increase in stock, or that the right is lessened in case the number of shares owned by the stockholder should be diminished.<sup>45</sup>

Statutes providing for the formation of cooperatives in many cases specify that members shall be entitled to only one vote on any question affecting the association. Unless each share of stock is given a vote by statute, those interested in forming an association may, if the incorporation statute authorizes, include a suitable provision in the articles of incorporation establishing what the voting unit at meetings of the stockholders shall be. Unless in conflict with the law of the State or with a provision in its charter, the members of an association may adopt a bylaw establishing what the voting unit at meetings of the association will be.<sup>46</sup>

If there is a statutory or charter provision dealing with the matter, it controls; a bylaw, to be valid, must be in harmony therewith. In case there is no statutory, charter, or bylaw provision on the subject, the common law rule of one vote for each member or stockholder prevails, without regard to the number of shares he may own. With respect to nonstock associations or corporations, this rule also prevails unless changed in one of the ways indicated. It should be observed that the generally accepted cooperative principle of one-man one-vote is merely an application of the

<sup>40</sup> *Everts v. Kansas Wheat Growers' Association*, 119 Kan. 276, 237 P. 1030; *Beale v. Columbia Securities Co.*, 256 Mass. 326, 152 N. E. 703.

<sup>41</sup> *Gentry-Futch Co. v. Gentry*, 90 Fla. 595, 106 So. 473.

<sup>42</sup> *Morrill v. Little Falls Manufacturing Co.*, 53 Minn. 371, 55 N. W. 547, 21 L. R. A. 174; *Alliance Coop. Ins. Co. v. Gasche*, 93 Kan. 147, 142 P. 882; *Gilchrist v. Collopy*, 119 Ky. 110, 82 S. W. 1018; *Green River Manufacturing Co. v. Bell*, 193 N. C. 367, 137 S. E. 132.

<sup>43</sup> *James R. Kirby Post No. 50 v. American Legion*, 258 Mass. 434, 155 N. E. 462.

<sup>44</sup> *Taylor v. Griswold*, 14 N. J. Law 222, 27 Am. Dec. 33; *Simon Borg & Co. v. New Orleans City R. Co.*, 244 F. 617; *In re Rochester District Telephone Co.*, 40 Hun. 172 (N. Y.); 7 R. C. L. 339.

<sup>45</sup> *Bailey v. Railroad Co.*, 89 U. S. 604, 635, 22 L. Ed. 840.

<sup>46</sup> *Detwiler v. Commonwealth ex rel. Dickinson*, 131 Pa. 614, 18 A. 990, 7 L. R. A. 357.

common law rule on the subject. It has been said that "There is no rule of public policy which forbids a corporation and its stockholders from making any contract they please in regard to restrictions on the voting power,"<sup>47</sup> provided the contracts do not violate any statutory or constitutional provisions, but if contrary to such provisions they have been held void.<sup>48</sup>

Cooperatives frequently own stock of other corporations. In the absence of restrictions in the articles of incorporation or bylaws of such a cooperative, it appears that its board of directors is free to determine how such stock shall be voted and action on the part of the members of the cooperative is unnecessary.<sup>49</sup>

### Proxy Voting

At common law every vote must be personally cast, and there is no right to vote by proxy.<sup>50</sup> Many of the cooperative statutes prohibit voting by proxies. It has been held that independent of statute a corporation may adopt a bylaw providing for voting by proxy, assuming, of course, that proxy voting is not prohibited by statute.<sup>51</sup> When proxy voting is permitted, it is not essential that the person to whom a proxy is given be himself a member or stockholder in the absence of a statute or bylaw requiring it.<sup>52</sup> Many of the cooperative statutes under which cooperatives are formed permit the establishment of the delegate system of representation at meetings of the association. Unless prohibited by statute, any nonprofit association would apparently be free to establish the delegate system of voting at its meetings.<sup>53</sup>

Where the statute under which a nonstock organization was incorporated authorized the adoption of bylaws providing for proxy voting but no such bylaw had been adopted, officers who were "elected" through votes cast by proxies were illegally elected and could be enjoined from carrying on the business of the corporation.<sup>54</sup>

A provision in the Agricultural Adjustment Act of 1937 authorized cooperatives to vote on behalf of their members on the matter of whether a marketing order should be adopted. The Supreme Court of the United States in upholding this provision said:<sup>55</sup>

This is not an unreasonable provision, as the cooperative is the marketing agency of those for whom it votes. If the power is in the Congress to put the order in effect, the manner of the demonstration of further approval is likewise under its control. These associations of producers of milk have a vital interest in the establishment of an efficient marketing system. This adequately explains their interest in securing the adoption of an order believed by them to be favorable for this purpose.

<sup>47</sup> *State ex rel. Frank v. Swanger*, 190 Mo. 561, 89 S. W. 872, 874, 2 L. R. A. (N. S.) 121; *Orme v. Salt River Valley Water Users' Association*, 25 Ariz. 324, 217 P. 935.

<sup>48</sup> *Brooks v. State*, 3 Boyce 1, 79 A. 790, 51 L. R. A. (N. S.) 1126, Ann. Cas. 1915A, 1133; *Gaskill v. Gladys Belle Oil Company*, 16 Del. Ch. 289, 146 A. 337.

<sup>49</sup> *Fower v. Provo Bench Canal & Irrigation Company*, 99 Utah 267, 101 P. 2d 375, certiorari denied 313 U. S. 564, 61 S. Ct. 841, 85 L. Ed. 1523.

<sup>50</sup> *Sagness v. Farmers' Cooperative Creamery Co.*, 67 S. D. 379, 293 N. W. 365; *Perry v. Tuskaloosa Cotton-Seed Oil-Mill Co.*, 93 Ala. 364, 9 So. 217; 14 C. J. 907. <sup>51</sup> *Sagness v. Farmers' Cooperative Creamery Company*, 67 S. D. 379, 293 N. W. 365.

<sup>52</sup> *Gentry-Futch Co. v. Gentry*, 90 Fla. 595, 106 So. 473.

<sup>53</sup> *People ex rel. Hoyne v. Grant*, 283 Ill. 391, 119 N. E. 344; *Orme v. Salt River Valley Water Users' Association*, 25 Ariz. 324, 217 P. 935.

<sup>54</sup> *Pohle v. Rhode Island Food Dealers Association*, 63 R. I. 91, 7 A. 2d 267.

<sup>55</sup> *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, 559, 59 S. Ct. 993, 83 L. Ed. 1446.



## Bankruptcies and Receiverships

THE question whether a cooperative is amenable to involuntary bankruptcy proceedings is one on which the courts have differed, although two circuit courts of appeals, the highest courts as yet to consider this question, have held that such associations are amenable to involuntary proceedings. The bankruptcy act provides: <sup>56</sup>

Any natural person, except a wage earner or farmer, and any moneyed, business, or commercial corporation, except a building and loan association, a municipal, railroad, insurance, or banking corporation, owing debts to the amount of \$1,000 or over, may be adjudged an involuntary bankrupt \* \* \*.

Does the foregoing language include a cooperative? In answering this question in the affirmative the Circuit Court of Appeals for the Sixth Circuit said in part: <sup>57</sup>

It is to be noted that the Bankruptcy Act refers not to corporations for profit, but to "business or commercial" corporations, and it is quite conceivable that a cooperative association might be organized to function without itself engaging in the conduct of any business. In such event it would doubtless not be amenable to the Bankruptcy Act. Doubtless, also, if the chief purpose of a corporation be religious, charitable, or educational it will not come within the purview of the Bankruptcy Act notwithstanding that some acts of business or commerce are incidentally performed. But where the chief purpose of the corporation is to carry on trade or commerce in an established field, and to do this primarily for the financial benefit of those who have joined in its organization and in the conduct of its affairs, there is but little room for doubt that the corporation is a "business or commercial" one within the intendment of the Bankruptcy Act.

On the other hand, a contrary view has been taken in several district court cases. Thus, in a case involving the Wisconsin Cooperative Milk Pool, the district court <sup>58</sup> refused to follow the rule of the Schuster case, just quoted, and held that a cooperative was not amenable to involuntary bankruptcy proceedings. However, as the footnote indicates, the circuit court of appeals subsequently reversed this decision. The subject in question has occasioned considerable discussion. <sup>59</sup>

Where members of a cooperative on its being placed in bankruptcy paid money to the trustee on account of a liability imposed upon them by the bylaws, it was held that the members were not entitled to recover such money because the liability under the bylaws was only to the creditors, since the trustee would distribute the funds among the creditors. It was further held that as the statute of limitations was simply a defense, the fact that

<sup>56</sup> 11 U. S. C. A. 22.

<sup>57</sup> *Schuster v. Ohio Farmers' Cooperative Milk Association*, 61 F. 2d 337. Followed in *In re South Shore Cooperative Association*, 4 F. Supp. 772. See also *In re Wisconsin Cooperative Milk Pool*, 119 F. 2d 999, reversing 35 F. Supp. 787; and *In re Wyoming Valley Coop. Association*, 198 F. 436; *In re Sedalia Farmers' Cooperative Packing and Produce Company*, 268 F. 898. Hanna, John. THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS. 509 pp. New York. 1931. See p. 336.

<sup>58</sup> *In re Wisconsin Cooperative Milk Pool*, 119 F. 2d 999, reversing 35 F. Supp. 787, 789. For similar holdings see *In re Dairy Marketing Association of Ft. Wayne, Inc.*, 8 F. 2d 626; *In re Weeks Poultry Community, Inc.*, 51 F. 2d 122.

<sup>59</sup> BANKRUPTCY—AMENABILITY OF FARMERS' MARKETING COOPERATIVES TO INVOLUNTARY PROCEEDINGS. 39 Mich. L. Rev. 1011 (1941); BANKRUPTCY—WHO MAY BECOME BANKRUPT—CORPORATIONS: COOPERATIVE MARKETING ASSOCIATION. 46 Harv. L. Rev. 326-327 (1932); Kalman, J. H. COOPERATIVE MARKETING ASSOCIATIONS, AMENABILITY TO INVOLUNTARY BANKRUPTCY, POWER TO CHANGE CONTRACTUAL RELATIONSHIPS BY ALTERING BYLAWS. 10 Wis. L. Rev. 516-520 (1935).

some of the members could have pleaded the statute if sued on such claims was immaterial.<sup>60</sup>

If cause therefor exists, a receiver may be appointed for a cooperative. Insolvency—that is, inability to meet the demands of creditors, generally speaking—is one of the most common causes for the appointment of a receiver.<sup>61</sup> In an Arkansas case<sup>62</sup> the court refused to appoint a receiver because of breaches of the marketing contract by the officers of the association, and refused to release the members involved from their contracts on account of such breaches. The court pointed out that “the rule is not to appoint a receiver when the specified acts complained of may be remedied by injunction or are capable of redress by other available means.”

Where the directors of a cooperative were unfaithful to their trust and were guilty of fraudulent practices, the appointment of a receiver was justified to preserve its property.<sup>63</sup>

Various facts and circumstances may operate to prevent the appointment of a receiver. It was held proper that action for the appointment of a receiver of a cooperative loan association was dismissed where the plaintiff owned only four shares of the stock of a par value of \$40, and the Federal intermediate credit bank, the only creditor, seemed to be satisfied with the way the business of the association was being conducted, and there was nothing to show that the plaintiff had sought, through the officers or stockholders, a limitation of its affairs or change in its personnel.<sup>64</sup>

“The power of appointment is a delicate one, and to be exercised with great circumspection.”<sup>65</sup> Thus, in the case just quoted, none of the following circumstances was held sufficient to warrant appointment of a receiver: failure of the officers to convince the Office of Price Administration that the association was entitled to higher prices; failure to permit stockholders to examine the cooperative’s books; operation of a breeding farm; procedure of the association in paying withdrawing members for their part of the reserve fund; the existence of dissension among members; mismanagement and misconduct which was not so “gross or fraudulent as to affect the substantial rights of stockholders or creditors”; and breach of the marketing contract by deducting 6 cents, instead of 5 cents, per hundred pounds of milk.

Even though deductions made by an association were unauthorized, it was held that this did not entitle certain members of an association to have a receiver appointed for the association and an accounting where these members did not object to the deductions at the time they were made.<sup>66</sup>

<sup>60</sup> *In re South Shore Cooperative Association*, 103 F. 2d 336, affirming 23 F. Supp. 743. See also *Huntington v. Waldorff*, 13 N. Y. S. 2d 783, 257 App. Div. 1025, affirmed 281 N. Y. 746, 23 N. E. 2d 554.

<sup>61</sup> *Emmett State Bank v. Emmett Farmers' Union Coop. Elevator & Mercantile Co.*, 116 Kan. 550, 227 P. 257; *In re Community Cooperative Industries, Inc.*, 279 Mich. 610, 273 N. W. 287; *In re Farmers Cooperative Co.*, 200 Iowa 1160, 206 N. W. 251; *O'Brien Mercantile Company v. Bay Lake Fruit Growers' Association*, 173 Minn. 493, 217 N. W. 940.

<sup>62</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419, 426.

<sup>63</sup> *California Fruit Growers' Association v. Superior Court*, 8 Cal. App. 711, 97 P. 769. See also *Lee v. Farmers Coop. Association of Mountain View*, 189 Okla. 55, 113 P. 2d 391.

<sup>64</sup> *Peebles v. South Carolina Agricultural Loan Association, Inc.*, 156 S. C. 429, 153 S. E. 283.

<sup>65</sup> *Indianapolis Dairymen's Cooperative, Inc. v. Bottema*, 226 Ind. 237, 79 N. E. 2d 399; 226 Ind. 260, 79 N. E. 2d 409. Cf. *Range v. Tennessee Burley Tobacco Growers Association*, — Tenn. —, 298 S. W. 2d 545.

<sup>66</sup> *Boyle v. Pasco Growers' Association, Inc.*, 170 Wash. 516, 17 P. 2d 6.

Where the stockholders of an association acquiesced in the apparently unauthorized investment of a part of its capital, the court refused to appoint a receiver.<sup>67</sup>

It was held that an assignment for the benefit of creditors did not prevent the appointment of a receiver for an insolvent cooperative.<sup>68</sup>

The function of a receiver is to collect the assets and apply them on the debts of the concern involved. For instance, if an association had overpaid a member and a receiver was appointed for the association, the receiver could sue the member and collect the amount of the excess payment.<sup>69</sup>

Where a cooperative loaned money to a receiver to preserve property in his possession, it was entitled to payment before a person who had a mortgage on the property.<sup>70</sup> In a receivership proceeding the assets of a cooperative may be marshaled.<sup>71</sup>

A receivership does not terminate or dissolve an association. It simply substitutes, for the life of the receivership,<sup>72</sup> the management of the receiver for the management of the officers and directors of the association.

Where a tobacco association entered into contracts with third persons to redry its tobacco and later the association was placed in the hands of a receiver, it was held that the redriers were not entitled to claim a lien on tobacco in their possession on account of money due for tobacco which had previously been redried and delivered, because the contracts under which the redrying of the tobacco had been done provided for an extension of credit which was inconsistent with the claim of a lien on the tobacco.<sup>73</sup>

## Marketing Contracts

A CONTRACT has been defined as an agreement between competent parties, upon sufficient consideration, to do or not to do a particular lawful thing.<sup>74</sup> To be binding and enforceable a contract must possess mutuality; that is, both parties must be bound, or neither will be. For instance, if one party agrees to sell a certain article, the other must agree to buy, or the agreement is void.<sup>75</sup> Preliminary negotiations between parties who have in mind the execution of a formal written contract cannot themselves be construed as constituting the contract.<sup>76</sup> In general, a cooperative may enter into all contracts necessary for the conduct of its business.<sup>77</sup>

A contract or agreement by which a member of a cooperative appoints the association his agent for the sale and marketing of his product, to be valid, should also contain a provision in which the association agrees to act as such agent and do the work involved. The question whether cooperative marketing contracts possess mutuality has been before the courts in many

<sup>67</sup> *Brookshire v. Farmers' Alliance Exchange of South Carolina, Limited*, 73 S. C. 131, 52 S. E. 867.

<sup>68</sup> *Milam County Cooperative Cotton and Mercantile Alliance v. Tennent-Stribling Shoe Company*, 40 S. W. 331 (Tex. Civ. App.).

<sup>69</sup> *Cunningham v. Long (Maine Potato Growers' Exchange)*, 125 Me. 494, 135 A. 198.

<sup>70</sup> *Colorado Wool Marketing Association v. Monaghan*, 66 F. 2d 313.

<sup>71</sup> *Leyden v. Calhoun Cooperative Creamery Company*, 233 Ala. 289, 135 So. 317.

<sup>72</sup> *Gaboury v. Central Vermont Ry. Co.*, 250 N. Y. 233, 165 N. E. 275.

<sup>73</sup> *Clark Brothers & Company v. Pou*, 20 F. 2d 74.

<sup>74</sup> Blackstone's COMMENTARIES, Book II, p. 442.

<sup>75</sup> *American Cotton Oil Co. v. Kirk*, 68 F. 791; *Willard, Sutherland & Co. v. United States*, 262 U. S. 489, 43 S. Ct. 592, 67 L. Ed. 1086.

<sup>76</sup> *Nickel v. Theresa Farmers Coop. Association*, 247 Wis. 412, 20 N. W. 2d 117; *A. E. Staley Mfg. Co. v. Northern Cooperatives, Inc.*, 168 F. 2d 892.

<sup>77</sup> *In re Farmers' Dairy Company's Receivership*, 177 Minn. 211, 225 N. W. 22.



cases. The courts have held that marketing contracts do possess mutuality.<sup>78</sup>

Inasmuch as marketing contracts universally require the association to do certain things, while obligating the members to do certain other things, the mutuality of such contracts appears to be beyond question.

The Supreme Court of Wisconsin has held that the language of the cooperative marketing act of that State is such that the marketing contracts of associations formed under it need not possess mutuality.<sup>79</sup>

A contract should be in writing and signed by both parties. It should clearly and fully set forth the rights, duties, and obligations of each of the parties. Particular care should be taken to make certain that the contract is clear upon every point involved. For when parties to a contract have apparently set forth in writing the understanding between them with reference to the matter involved, it is presumed to represent the entire agreement of the parties thereto, and ordinarily it cannot be successfully disputed by oral evidence.<sup>80</sup>

There are circumstances, however, in which oral testimony may be introduced to show the real character of a contract. Thus where the financial return to a renter member was substantially larger per unit than that of a regular member, it was held that a grower who had signed a regular member's marketing agreement on the back of which was placed the words "renter member," although the contract on its face did not contain any such term, could introduce oral evidence for the purpose of showing what was meant by the term "renter member," and have his rights determined accordingly.<sup>81</sup> Under similar circumstances, where it appeared that the association and the grower at the time a regular member's marketing agreement was signed both understood that the grower was to be a renter member, it was held that the marketing agreement could be reformed to accord with this fact.<sup>82</sup> Again when it appeared that the marketing contract had been orally modified to guarantee a member a given amount of money for prunes "and pay in addition thereto such sum per ton as the prunes might bring net above \$15" it was held that the contract as modified was binding on the association and that, as the association had not pleaded that the contract was ultra vires, it was barred from making this defense.<sup>83</sup> Also, where the parties to a marketing contract consistently followed a method of payment from the outset for milk delivered which was different from that set forth in the written contract, it was held that they had modified

<sup>78</sup> *Warren v. Alabama Farm Bureau Cotton Association*, 213 Ala. 61, 104 So. 264; *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *Milk Producers' Marketing Co. v. Bell*, 234 Ill. App. 222; *Burley Tobacco Growers' Coop. Association v. Rogers*, 88 Ind. App. 469, 150 N. E. 384; *Louisiana Farm Bureau Cotton Growers' Coop. Association v. Clark*, 160 La. 294, 107 So. 115; *Minnesota Wheat Growers' Coop. Marketing Association v. Huggins*, 162 Minn. 471, 203 N. W. 420; *Oregon Growers' Coop. Association v. Riddle*, 116 Ore. 562, 241 P. 1011; *Dark Tobacco Growers' Coop. Association v. Mason*, 150 Tenn. 228, 263 S. W. 60.

<sup>79</sup> *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391.

<sup>80</sup> *Dark Tobacco Growers' Coop. Association v. Mason*, 150 Tenn. 228, 263 S. W. 60; *Elmore v. Maryland & Virginia Milk Producers' Association, Inc.*, 145 Va. 42, 132 S. E. 521, 134 S. E. 472.

<sup>81</sup> *California Canning Peach Growers v. Williams*, 11 Cal. 2d 221, 78 P. 2d 1154, 11 Cal. 2d 233, 78 P. 2d 1161.

<sup>82</sup> *Stafford v. California Canning Peach Growers*, 11 Cal. 2d 212, 78 P. 2d 1150. See also *California Canning Peach Growers v. Harkey*, 11 Cal. 2d 188, 78 P. 2d 1137.

<sup>83</sup> *Yakima Fruit Growers' Association v. Hall*, 180 Wash. 365, 40 P. 2d 123. See also *California Canning Peach Growers v. Harkey*, 11 Cal. 2d 188, 78 P. 2d 1137; *California Canning Peach Growers v. Williams*, 11 Cal. 2d 221, 78 P. 2d 1154, 11 Cal. 2d 233, 78 P. 2d 1161; *Stafford v. California Canning Peach Growers*, 11 Cal. 2d 212, 78 P. 2d 1150.

the written contract by mutual agreement and the written provision was not enforceable.<sup>84</sup> But where an association, in its marketing contract, agreed to pay a grower an additional amount in the event the prunes sold for net prices higher than those paid at the time of delivery, the promise to pay an additional amount was conditional and the failure to make such a payment did not relieve a grower from his obligation to deliver under his contract.<sup>85</sup> If a contract contains a trade term, oral testimony is admissible to show its meaning and when a marketing contract did not define the term "optional pool" testimony was admissible to do so.<sup>86</sup>

The statement in a marketing contract that the association was to sell the commodities "at the best prices obtainable by it under market conditions" did not "mean the best prices that could be obtained by it in any one year or on several different dates during the same season" and it was held that the foregoing requirement was met if the officers of the association acted in good faith and in a reasonable manner.<sup>87</sup> When a contract or any provision thereof is ambiguous, the courts will adopt the practical construction which the parties have placed thereon and, in a certain case in which it was contended that a producer who had breached his contract was liable to a penalty of \$25 for each day the breach continued, the court restricted the association to recovering only \$25, because in previous instances this was the amount that members had been required to pay.<sup>88</sup>

Subject to restrictions contained in the statute under which an association is formed or in its charter, an association has wide latitude with respect to the provisions it may include in its marketing contract. It may provide for any plan or device that is not contrary to law. For instance, an association may provide in its contract that it has the right to enter into contracts with producers different from the one in question.<sup>89</sup> Likewise an association has wide latitude as to the manner in which it contracts with its members. It has been said—

There is no reason why persons *sui juris* may not agree to be bound by the articles, bylaws, rules, and regulations of the association of which they are members.<sup>90</sup>

If an association is entering into a long-term contract with members, it is advisable to include therein a provision permitting the association to enter into contracts in the future, with other producers, different from the instant ones. By this means, new contracts may be made which embody improvements and changes deemed desirable without the necessity of "signing up" the producers who sign the original contract; but the old members should be given an opportunity of signing the new contracts if they wish to do so. Thus the provision in the old contract authorizing the making of contracts different from the original one should specify that producers who have signed the same on request may sign the new contract.

<sup>84</sup> *Matanuska Valley Farmers Cooperative Association v. Monaghan*, 188 F. 2d 906.

<sup>85</sup> *California Prune & Apricot Growers, Inc. v. Baker*, 77 Cal. App. 393, 246 P. 1081.

<sup>86</sup> *Burch v. South Carolina Cotton Growers' Coop. Association*, 181 S. C. 295, 187 S. E. 422.

<sup>87</sup> *Arkansas Cotton Growers' Coop. Association v. Brown*, 179 Ark. 338, 16 S. W. 2d 177.

<sup>88</sup> *Fort Dodge Cooperative Dairy Marketing Association v. Ainsworth*, 217 Iowa 712, 251 N. W. 85. See also *Loomis Fruit Growers' Association v. California Fruit Exchange*, 128 Cal. App. 265, 16 P. 2d 1040; *Wheelwright v. Pure Milk Association*, 208 Wis. 40, 240 N. W. 769, 242 N. W. 486; *Mosher Grain v. Kansas Coop. Wheat Marketing Association*, 136 Kan. 269, 15 P. 2d 421.

<sup>89</sup> See *Cooperative Milk Service, Inc. v. Hepner*, 198 Md. 104, 81 A. 2d 219.

<sup>90</sup> *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 380, 77 A. L. R. 391.

Cooperatives, as well as their members, should carefully observe the contracts entered into by them. In a Michigan case in which members of an association alleged that the association had violated the terms of the marketing agreement entered into with them and had diverted money due them, it was held they were entitled to maintain an action against the association for an accounting.<sup>91</sup> When a milk association entered into marketing agreements with its members, providing the basis on which the association would account to its members for their milk, the board of directors of the association could not, at least against a member who had not consented thereto, provide for a different method of accounting to members for their milk.<sup>92</sup>

Long before the advent of cooperative marketing, the courts enforced crop contracts under which the seller agreed to deliver to the buyer the crop to be grown on his farm or on certain land,<sup>93</sup> so that, aside from the cooperative feature, there is nothing inherently new in the idea of a producer entering into such a contract.

Provisions are sometimes included in marketing contracts which permit members, with the approval of the association, to dispose of products covered thereby outside the association. In upholding the validity of such a provision and of the action of the association thereunder, the Supreme Court of Washington said <sup>94</sup>—

it now may be considered settled law that, in the absence of arbitrary action, unfair discrimination, fraud, or something of like nature, the general control conferred upon the association by the contract will not be interfered with by the courts.

Under provisions like that under discussion, inasmuch as an association could refuse permission to a member to sell products to third persons, the permission of the association may be conditioned on the member complying with or meeting terms which it specifies.

Where a grower was under contract to market all his produce (subject to certain exceptions) through an association and on account of adverse marketing conditions the association was not able to market such produce, it was held that the association was justified in refusing to accept the produce tendered. On the other hand, it was held that the association, in refusing to permit the grower to market his produce through other channels, thereby breached its marketing agreement.<sup>95</sup> In another case,<sup>96</sup> involving a milk association, it was held a demand made by the association, that a member install expensive appliances on his premises for the proper cooling of milk "and imposing upon him an expense which made it impossible for him to comply with the contract" which he had entered into with the association, might relieve the member of his obligation to do so. Apparently the member had not obligated himself in his contract to install appliances of the type in question.

<sup>91</sup> *Pedowski v. Southern Michigan Fruit Association*, 261 Mich. 271, 246 N. W. 58.  
<sup>92</sup> *Rhodes v. Little Falls Dairy Company, Inc.*, 230 App. Div. 571, 245 N. Y. S. 432, affirmed in 256 N. Y. 559, 177 N. E. 140; *Fietz v. Central Milk Producers Coop. Association, Inc.*, 32 N. Y. S. 2d 574.

<sup>93</sup> *Briggs v. United States*, 143 U. S. 346, 12 S. Ct. 391, 36 L. Ed. 180; *Butt v. Ellett*, 19 Wall. 544, 86 U. S. 544, 22 L. Ed. 183; *Dickey v. Waldo*, 97 Mich. 255, 56 N. W. 608, 23 L. R. A. 449.

<sup>94</sup> *Olympia Milk Producers' Association v. Herman*, 176 Wash. 338, 29 P. 2d 676, 679. See also *Washington Coop. Egg & Poultry Association v. Taylor*, 122 Wash. 466, 210 P. 806.

<sup>95</sup> *Gughelmelli v. Walla Walla Gardeners' Association*, 157 Wash. 109, 288 P. 251, 77 A. L. R. 385.

<sup>96</sup> *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391.



A member of a marketing cooperative was evacuated from leased premises and executed a power of attorney which designated the association to care for growing crops during one year but did not provide for growing or marketing crops in subsequent years. It was held that he ceased to be a producer upon his evacuation and his failure to return after his release constituted a voluntary abandonment of his membership in the association.<sup>97</sup>

In a case involving a milk bargaining cooperative, the marketing agreement of the association permitted its members to market milk in a given market, provided the milk was not sold "for less than the price agreed upon and fixed by the association as the minimum price." This contract was held valid.<sup>98</sup> On the other hand where a marketing contract provided that "the association agrees to buy and the producer agrees to sell to it all milk produced or acquired by the producer" but the association in fact handled no milk, it was held that a producer was entitled to have his milk contract canceled when the association refused to receive his milk.<sup>99</sup>

If under a marketing agreement an association is required to consult with its members prior to the sale of their products, an association may be liable for damages if it fails to consult with them before effecting a sale.<sup>1</sup> An association which agrees in its marketing contract to pick, harvest, and market crops, at such time as shall be mutually agreed upon, is liable in damages to the grower if it fails to do so at the time agreed upon.<sup>2</sup>

A producer, who was a member of a milk marketing association and had received from it a basic milk allotment, sold one-half of his herd of dairy cows to a person who had previously been entitled to receive from the producer one-half of the proceeds realized from the sale of milk. The producer contended, following the sale of one-half of his dairy cows, that he was entitled to have the association compute the amount to be paid him for milk delivered to the association "upon the basic average that would have been used to make such computation had the herd not been divided." It was held, however, that under its bylaws, which were specifically made a part of the marketing agreement, the association had the right to readjust the basic allotment of the producer, following the sale of one-half of the herd.<sup>3</sup>

Where cotton was received by an association to be sold only on instructions from the member in accordance with rules and regulations established by the board of directors of the association giving its members various options with respect to the sale of cotton delivered by them, it was held that the association was not guilty of conversion because it sold cotton, without instructions from the member, as the contract was construed to mean that such sales could be made provided an amount of cotton of equal grade and quality was kept on hand by the association.<sup>4</sup>

In some instances marketing contracts contain provisions for the payment of attorney fees to the association, in the event it enforces the contract through a suit.<sup>5</sup> Many of the cooperative statutes specifically author-

<sup>97</sup> *Hiroshi Kaneko v. Jones*, 235 P. 2d 768 (Ore.).

<sup>98</sup> *Johnson v. Georgia-Carolina Retail Milk Producers Association*, 182 Ga. 695, 186 S. E. 824.

<sup>99</sup> *Central Texas Dairymen's Association v. Jones*, 67 S. W. 2d 896 (Tex. Civ. App.).

<sup>1</sup> *Texas Cotton Cooperative Association v. Lennox*, 55 S. W. 2d 53 (Tex. Com. App.), reversing 37 S. W. 2d 331.

<sup>2</sup> *Winter Garden Citrus Growers' Association v. Willits*, 113 Fla. 131, 151 So. 509.

<sup>3</sup> *Rhoten v. Dairy Cooperative Association*, 155 Ore. 402, 64 P. 2d 523.

<sup>4</sup> *Alabama Farm Bureau Cotton Association v. Dale*, 223 Ala. 164, 134 So. 646. See also *South Carolina Cotton Growers' Coop. Association v. Weil*, 220 Ala. 568, 126 So. 637.

<sup>5</sup> *Kansas Wheat Growers' Association v. Windhorst*, 129 Kan. 528, 283 P. 638, 131 Kan. 423, 292 P. 777, 132 Kan. 21, 294 P. 928.

ize the inclusion in the bylaws of an association, or in its marketing contracts, of a stipulation for the payment of attorney fees. It has been held that a marketing contract may continue in effect after membership in an association has ceased.<sup>6</sup>

An association or a member thereof may waive rights or conditions provided for in marketing contracts. For instance, where an association was authorized to sell rice, at such price as it might determine in the absence of a written notice from a member, the requirement that such a notice be in writing was waived when the member refused to approve a sale of his rice at a price submitted by the association and a sale at such price by the association was held invalid.<sup>7</sup>

If marketing contracts entered into by producers with a cooperative provide that they may be assigned by the cooperative to another association, such a provision is valid, but if it is intended to have such contracts assigned care should be exercised to provide procedure for making the producers members of the assignee association. In two California cases<sup>8</sup> in which marketing contracts were assigned, it was held that the producers were not members of the association to which their contracts had been assigned.

### **When May Cooperative Marketing Contracts Be Made?**

How early in the formation of a cooperative may producers enter into marketing contracts? May producers prior to the actual incorporation of an association make valid marketing contracts with it? According to the weight of authority, producers may sign marketing contracts which constitute an offer to contract with the proposed cooperative before its incorporation, and on the acceptance of this offer by the cooperative after its incorporation a binding contract results.<sup>9</sup>

A producer may withdraw his offer to contract prior to its acceptance and thus prevent a binding obligation from coming into existence, unless the language of the contract shows that each producer signs because others have done so and for the purpose of inducing still others to sign contracts. But if the language of the contract is framed along the lines indicated or contains language showing that each producer receives some consideration for keeping his offer to contract open, then according to the weight of authority the offer may not lawfully be withdrawn.<sup>10</sup> Of course, after an association is incorporated it may freely contract.

### **Kinds of Cooperative Marketing Contracts**

What kinds of marketing contracts may producers make with their cooperatives? Any kind that is consistent with law, but, to be more specific, the

<sup>6</sup> *Milk Producers' Association v. Webb*, 97 Cal. App. 650, 275 P. 1001.

<sup>7</sup> *Standard Rice Milling Company v. Scott*, 174 Ark. 1180, 295 S. W. 401. See also *Yakima Fruit Growers' Association v. Hall*, 180 Wash. 365, 40 P. 2d 123; *California Prune & Apricot Growers Inc. v. Baker*, 77 Cal. App. 393, 246 P. 1081; *Producers' Fruit Company of California v. Goddard*, 75 Cal. App. 737, 243 P. 686.

<sup>8</sup> *Sun-Maid Raisin Growers of California v. Paul A. Mosesian & Son, Inc.*, 90 Cal. App. 1, 265 P. 828; *Sun-Maid Raisin Growers of California v. K. Arakelian, Inc.*, 90 Cal. App. 10, 265 P. 832.

<sup>9</sup> *Hart Potato Growers' Association v. Greiner*, 236 Mich. 638, 211 N. W. 45; *Washington Wheat Growers' Association v. Leifer*, 132 Wash. 602, 232 P. 339; *Burley Tobacco Growers' Coop. Association v. Rogers*, 88 Ind. App. 469, 150 N. E. 384; *Jefferson County Farm Bureau v. Stewart*, 235 Ill. App. 370; *Texas Farm Bureau Cotton Association v. Lennox*, 257 S. W. 935 (Tex. Civ. App.); *Meyers v. Wells*, 252 Wis. 352, 31 N. W. 2d 512; 14 C. J. 257, 17 R. C. L. 81.

<sup>10</sup> *Collins v. Morgan Grain Co.*, 16 F. 2d 253; *Coleman Hotel Co. v. Crawford*, 3 S. W. 2d 1109, 61 A. L. R. 1459 (Tex. Com. App.).

contract may be of the purchase-and-sale type or of the agency type if the statute under which the association is formed authorizes either or both types. If the statute is silent as to the type of contract that may be adopted, then it would appear that an association may adopt either type.

In the preparation of contracts it should be kept in mind that the right to contract is a fundamental and comprehensive one and that unless prohibited by law or public policy, persons may contract as they desire.<sup>11</sup> Marketing contracts should be clear and unambiguous and consistent with the statute under which the association is incorporated, its articles of incorporation and bylaws.<sup>12</sup>

Many of the cooperative statutes expressly authorize purchase-and-sale as well as agency contracts. Under either type of contract, the obligation of the cooperative, generally speaking, is the same, namely, to return the sale price of the producers' products on the basis prescribed in the contract, less authorized deductions. In purchase-and-sale contracts, the purchase price can be the resale price, less authorized deductions. The fact that a specific purchase price is not named in the contract is immaterial because that is definite which can be made definite.<sup>13</sup>

In commercial contracts title passes although the amount to be paid for the goods in question may depend on the resale price received for them.<sup>14</sup> "Under ordinary conditions, a valid agreement can be made for purchase and sale without the fixing of a specific price."<sup>15</sup> Moreover, if a statute authorizes a purchase-and-sale contract, this resolves all doubt as to the passing of title as it is certainly competent for the legislature to prescribe the conditions which shall be sufficient to pass title to products.

In a certain case<sup>16</sup> it was said:

We are dealing here with a special form of statutory contract, whose nature and legal effect are defined and determined by the act under which the contract has been made between the parties. It is clear, therefore, that such agreement need not conform to the essentials of an ordinary contract of sale as to the certainty of the price.

Just as a State may prescribe what shall constitute a deed which shall be sufficient to pass title to land, it has the power to declare what shall be sufficient to pass title to farm products. At common law independent of statute, if a cooperative employs a purchase-and-sale contract it should be held to pass title to the products to the association. In such contracts the parties agree and declare that the association buys and that the member sells. In the forms of such contracts generally employed there are no provisions inconsistent with the passing of title. Therefore the clear declaration of the parties with respect thereto should be given effect.<sup>17</sup>

<sup>11</sup> *Morlock v. Mt. Forest Fur Farms of America*, 269 Mich. 549, 257 N. W. 880.

<sup>12</sup> *Silveira v. Associated Milk Producers*, 63 Cal. App. 572, 219 P. 461; *Buford v. Florin Fruit Growers' Association*, 210 Cal. 84, 291 P. 170.

<sup>13</sup> *South Carolina Cotton Growers' Coop. Association v. Weil*, 220 Ala. 568, 126 So. 637; *Texas Farm Bureau Cotton Association v. Stovall*, 113 Tex. 273, 253 S. W. 1101, reversing 248 S. W. 1109 (Tex. Civ. App.); *Brown v. Georgia Cotton Growers' Coop. Association*, 164 Ga. 712, 139 S. E. 417.

<sup>14</sup> *Balch v. Ashton & Co.*, 54 Iowa 123, 6 N. W. 146.

<sup>15</sup> *United States v. Swift & Co., and Swift & Co. v. United States*, 270 U. S. 124, 141, 46 S. Ct. 308, 70 L. Ed. 497.

<sup>16</sup> *Louisiana Farm Bureau Cotton Growers' Coop. Association v. Clark*, 160 La. 294, 107 So. 115, 118; *Texas Farm Bureau Cotton Association v. Stovall*, 113 Tex. 273, 253 S. W. 1101, reversing 248 S. W. 1109 (Tex. Civ. App.); *Brown v. Georgia Cotton Growers' Coop. Association*, 164 Ga. 712, 139 S. E. 417; *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391.

<sup>17</sup> See *Olson v. Biola Coop. Raisin Growers Association*, 184 P. 2d 742; affirmed, 193 P. 2d 929; 33 Cal. 2d 664, 204 P. 2d 10.



It is universally held that the intention of the parties is the dominant consideration in determining if title passes under a given instrument.<sup>18</sup> No better evidence of the intention of the parties could be had than their clear statement that the one sells and the other buys the products involved. The courts in numerous cases in which the contracts involved contained statements consistent with both sale and agency have held that title to the goods in question passes.<sup>19</sup>

In the purchase-and-sale contracts there may be certain practical advantages in that it should be easier ordinarily to negotiate a loan on products to which the borrower has title, as the right to borrow money would be apparent; but if an agency contract authorizes an association to borrow money on products received under it, the right of an association to do so is clear. As is well known, the stocks and bonds purchased by brokers for their customers that are carried on margin constitute a substantial part of their business. These brokers do not take title to the stocks; title to them is in the purchasers.<sup>20</sup> Brokers daily borrow immense sums of money from banks on stocks and bonds thus held by them. The authority of the broker to borrow money on such stocks comes from the fact that the customer has authorized him to do so.

In buying from a cooperative, there will probably be those who prefer to buy from one that has title rather than from one that acts as agent. In one case the cautious buyer would seek to learn if the association had "good title" to the products it was offering for sale, and in the other case, the cautious buyer would seek to learn if the association was authorized to sell the products.

So far as enforcement is concerned, the cooperative acts<sup>21</sup> generally authorize associations formed under them, whether employing an agency or a purchase-and-sale contract, to provide for liquidated damages and they are also given the remedies of injunction and specific performance to compel members to deliver their products to an association. The courts enforce agency<sup>22</sup> and purchase-and-sale<sup>23</sup> contracts without discrimination.

When an association is authorized to borrow money on products received from members, persons taking a lien on products after their delivery to an association as security for a loan made to it are as safe under an agency<sup>24</sup> as under a purchase-and-sale contract, because superior liens in either case acquired prior to delivery of the products would take precedence over those subsequently acquired; and any action affecting the products taken after the delivery of the products and after the granting of liens by the associa-

<sup>18</sup> 23 R. C. L. 1216; 46 Am. Jur. sec. 413.

<sup>19</sup> *Ferry & Co. v. Hall*, 188 Ala. 178, 66 So. 104, L. R. A. 1917B 620; *Mishawaka Woolen Mfg. Co. v. Westveer*, 191 F. 465.

<sup>20</sup> *Richardson, Trustee in Bankruptcy v. Shaw*, 209 U. S. 365, 28 S. Ct. 512, 52 L. Ed. 835, 14 Ann. Cas. 981; *Duel v. Hollins*, and *Wiener, Levy & Co. v. Hollins*, 241 U. S. 523, 36 S. Ct. 615, 60 L. Ed. 1143.

<sup>21</sup> See sec. 17 of Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>22</sup> *Elephant Butte Alfalfa Association v. Rouault*, 33 N. M. 136, 262 P. 185; *Oregon Growers' Coop. Association v. Lentz*, 107 Ore. 561, 212 P. 811; *Elmore v. Maryland & Virginia Milk Producers' Association, Inc.*, 145 Va. 42, 132 S. E. 521, 134 S. E. 472.

<sup>23</sup> *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311; *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231; *Texas Farm Bureau Cotton Association v. Stovall*, 113 Tex. 273, 253 S. W. 1101, reversing 248 S. W. 1109 (Tex. Civ. App.).

<sup>24</sup> *Phez Co. v. Salem Fruit Union*, 103 Ore. 514, 201 P. 222, 205 P. 970, 25 A. L. R. 1090.

tion would have to respect the liens given by the association and conform to them.

In the event an association using a purchase-and-sale contract were to fail, having on hand products or the money derived from the sale of them, a question would arise whether the members under such contracts were merely common creditors along with other unsecured creditors or whether they were preferred creditors. Apparently they would be common creditors, as this is the general rule in analogous situations in which title to goods that have not been paid for has passed.<sup>25</sup> Again, when title to the products passes to an association, as is the case under the purchase-and-sale form, a creditor of the association after obtaining a judgment could seize a sufficient quantity of the products to satisfy his judgment.<sup>26</sup>

It has been said that even under a purchase-and-sale contract an association is essentially operating on an agency basis.<sup>27</sup> There would appear to be more basis for this view in regard to the fiduciary duties of an association to its members than in any other respect.<sup>28</sup>

If an association operates with an agency marketing contract, members would not be common creditors in the event of failure of the association.<sup>29</sup> On the contrary, they would be entitled to receive full returns in accordance with their contracts or the return of their products, although to do so might leave creditors of the association unpaid. Any other rule would mean that the property to which the members had title could be taken to satisfy debts of the association, and it should be remembered that an association is an entity separate and apart from its members. Again the fundamental rule is that property in the hands of an agent for the purpose of sale may not be seized by creditors of the agent to satisfy claims they have against him.

During World War II, this issue was involved in cases brought by the Office of Price Administration in which it was alleged that cooperative dairies were paying to patrons amounts in excess of sums which could be paid to producers of milk under the price regulations. The cooperatives argued that they were merely agents of their members in selling their milk and, therefore, the regulations were not violated so long as the farmers did not receive more than they would be entitled to receive had they sold their milk directly to consumers. In one case,<sup>30</sup> the court concluded that even though the association was using a purchase-and-sale type of contract, it was simply acting as agent for its patrons in the sale of their milk. In an unreported case in Pennsylvania the opposite conclusion was reached.<sup>31</sup>

<sup>25</sup> *McKenzie v. Roper Wholesale Grocery Co.*, 9 Ga. App. 185, 70 S. E. 981; *Heryford v. Davis*, 102 U. S. 235, 26 L. Ed. 160, 2 Ky. Law Rep. 95.

<sup>26</sup> *McKenzie v. Roper Wholesale Grocery Co.*, 9 Ga. App. 185, 70 S. E. 981.

<sup>27</sup> *Rhodes v. Little Falls Dairy Company, Inc.*, 230 App. Div. 571, 245 N. Y. S. 432, affirmed in 256 N. Y. 559, 177 N. E. 140; *Mountain States Beet Growers' Marketing Association v. Monroe*, 84 Colo. 300, 269 P. 886. See also *Colorado-New Mexico Wool Marketing Association v. Manning*, 96 Colo. 186, 40 P. 2d 972.

<sup>28</sup> Hanna, John. *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS*. 509 pp. New York. 1931. See p. 211; Evans, Frank and Stokdyk, E. A. *THE LAW OF AGRICULTURAL COOPERATIVE MARKETING*. 648 pp. Rochester, N. Y. 1937. See p. 145; *Bogardus v. Santa Ana Walnut Growers' Association*, 41 Cal. App. 2d 939, 108 P. 2d 52, and cases cited therein.

<sup>29</sup> *First National Bank of Elgin v. Kilbourne*, 127 Ill. 573, 20 N. E. 681, 11 Am. St. Rep. 174; *Lambert v. Military Ridge Cheese Company*, 179 Wis. 359, 191 N. W. 555; *National Bank v. Ins. Co.*, 104 U. S. 54, 26 L. Ed. 693; *Union Stock Yards National Bank v. Gillespie*, 137 U. S. 411, 11 S. Ct. 118, 34 L. Ed. 724; 23 C. J. 352.

<sup>30</sup> *Bowles v. Inland Empire Dairy Association*, 53 F. Supp. 210.

<sup>31</sup> *Bowles v. Lehigh Valley Cooperative Farmers, Fed. Dis't Ct., E. D. Penn.*, File No. 3484, decided November 8, 1944.

The issue was finally obviated by a change in the O. P. A. regulations which recognized that patronage refunds of a bona fide cooperative did not violate the price regulations.

Sometimes the rights of associations insofar as third persons are concerned are affected by whether a contract is an agency or a purchase-and-sale contract. A New York statute required buyers of milk and cream from producers to give bonds to insure payment therefor. It was held in a case in which a cooperative took title to the milk and cream which it received from its members that it was not entitled to the protection of the bond given by a buyer to whom it sold milk and cream because the association was not regarded as a producer.<sup>32</sup>

In a subsequent case involving a cooperative that operated on an agency basis a like conclusion was reached,<sup>33</sup> but later it was held<sup>34</sup> that a cooperative operating on an agency basis was entitled to the protection of the bond. In this case the court, in referring to the fact that the cooperative mingled the milk of different producers, said—

Irrespective of this mingling, the contract was one of agency and not of purchase-and-sale.

It has been held that in computing its liability for a State franchise tax based upon the amount of business done by a corporation "within this State," a farming corporation could exclude transactions involving the sale in other States of agricultural commodities through brokers and, also, through agricultural cooperatives functioning on an agency basis.<sup>35</sup>

Under the Agricultural Adjustment Act of 1937 the word "purchased" was construed as meaning "acquired for marketing" and thus it was found applicable to cooperatives that operated on an agency basis, as well as to those functioning on a purchase-and-sale basis.<sup>36</sup>

In a Minnesota case<sup>37</sup> recovery of excess payments for products was denied the trustee in bankruptcy for a cooperative creamery on the grounds that the contractual relationship between the creamery and its patrons was one of purchaser and seller; not that of principal and agent.

If the papers defining the relationship between an association and its members do not state the capacity in which the association receives and markets their products but simply provide for the marketing of their products by the association, the relationship is one of agency, and title to the products does not pass to the association.

In a Maine case<sup>38</sup> in which the marketing contract did not specify whether it was a purchase-and-sale or an agency contract, a member's fruit froze after gathering but before delivery to the association. The court held that the contract was an agency contract and that the loss fell entirely on the grower.

In a purchase-and-sale contract a provision may be included placing the risk incident to the deterioration and loss of the crop on the member even after title to it has passed to the association.

<sup>32</sup> *Wilson v. Israel*, 227 N. Y. 423, 125 N. E. 819.

<sup>33</sup> *People v. Shoemaker*, 239 N. Y. S. 71, 228 App. Div. 314, affirmed in 254 N. Y. 567, 173 N. E. 869.

<sup>34</sup> *Pyrke v. Brudno*, 243 App. Div. 493, 278 N. Y. S. 353, affirmed in 269 N. Y. 652, 200 N. E. 42.

<sup>35</sup> *Irvine Co. v. McColgan*, 26 Cal. 2d 160, 157 P. 2d 847.

<sup>36</sup> *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, 59 S. Ct. 993, 83 L. Ed. 1446. But see *State v. Dairy Distributors*, 217 Wis. 167, 258 N. W. 386.

<sup>37</sup> *Elliott v. Adeckes*, 240 Minn. 113, 59 N. W. 2d 894. See also the discussion under "Excess Advances or Payments" on p. 113.

<sup>38</sup> *Haarparinne v. Butter Hill Fruit Growers' Association*, 122 Me. 138, 119 A. 116. Cf. *Fjeldahl v. Homer Coop. Association*, 11 Alaska Repts. 112.



A Wisconsin statute, under which buyers of products from a member of a cooperative were bound by a member's assignment of funds to the association provided specified formalities concerning filing of the assignment and notice to buyer were complied with, was held applicable only where there is a sale of such products. The farmer-members of the cooperative had entered into contracts with a processor, under which they agreed to plant seed peas furnished without charge by the canning company, and harvest and deliver the crop to the company for a specified compensation based on the quantity delivered. On these facts, the court held that the reservation by the company of title to the seed and the crop to be grown therefrom was valid, and the delivery of the peas under the contract was not a "sale" (1) within a contract by which the farmer had assigned to the cooperative a percentage of the receipts from the sale of the products, or (2) within the State statute under which the buyer of such products from a member of a cooperative is bound to recognize the member's assignment of funds to the association.<sup>39</sup>

### When Marketing Contracts Become Effective

Marketing contracts frequently contain a provision that they will not become effective until contracts covering a specified acreage or portion of the products in question have been obtained. The power of deciding when the specified conditions exist is usually left with the board of directors or a special committee appointed for the purpose. Such a provision is valid, and the decision made with respect to it is binding unless fraud or bad faith is established by the persons challenging the correctness of the decision.<sup>40</sup> If the data submitted to the board of directors or the executive committee that was vested with authority to make the decision in question are false, and known to be false by those submitting them, then the decision based thereon may be upset even though the board or committee acted in good faith.<sup>41</sup>

In a Michigan case, a marketing agreement under which a grower had delivered his potato crop to the association for two seasons was held ineffective because the association had employed an improper method of ascertaining that sufficient acreage had been placed under contract to make the marketing agreements operative. The court was of the opinion that since the grower had no knowledge of the method used in computing the acreage under contract, he was not estopped from questioning the validity of the contract by performance under it.<sup>42</sup>

<sup>39</sup> *Cash Crops Coop. v. Green Giant Co.*, 263 Wis. 353, 57 N. W. 2d 376.

<sup>40</sup> *Rowland v. Burley Tobacco Growers' Coop. Association*, 208 Ky. 300, 270 S. W. 784; *Washington Wheat Growers' Association v. Leifer*, 132 Wash. 602, 232 P. 339; *Pittman v. Tobacco Growers' Coop. Association*, 187 N. C. 340, 121 S. E. 634; *Poultry Producers of Central California v. Nilsson*, 197 Cal. 245, 239 P. 1086; *Martinsburg & Potomac Railroad Co. v. March*, 114 U. S. 549, 5 S. Ct. 1035, 29 L. Ed. 255; *New England Trust Co. v. Abbott, Ex'r*, 162 Mass. 148, 38 N. E. 432, 27 L. R. A. 271; *Berger Mfg. Co. v. Huggins*, 242 F. 853; *Bower-Venus Grain Co. v. Norman Milling & Grain Co.*, 86 Okla. 152, 207 P. 297; *Gratiot St. Warehouse Co. v. Wilkinson*, 94 Mo. App. 528, 68 S. W. 581; *Hayes Grain & Commission Co. v. Federal Grain Co.*, 169 Ark. 1072, 277 S. W. 521. The principle involved is applicable to any matter or thing.

<sup>41</sup> *Northwest Hay Association v. Chase*, 136 Wash. 160, 239 P. 1; *Wenatchee Dist. Coop. Association v. Mohler*, 135 Wash. 169, 237 P. 300.

<sup>42</sup> *Edmore Marketing Association v. Skinner*, 248 Mich. 695, 227 N. W. 681. (For discussion of this case, see Hanna, John. *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS*, 509 pp. New York. 1931. See p. 191.) See also *Kansas Wheat Growers' Association v. Bridges*, 133 Kan. 397, 1 P. 2d 265.

Where the chairman of the organization committee was required to sign a written statement to the effect that all conditions requisite to putting the marketing contract into effect had been performed and he had failed to do so, this was held to be a good defense to a suit against a member on his marketing contract.<sup>43</sup>

In view of the fact that a member of an organization committee did not investigate the correctness of a report made by a subcommittee, he was held estopped from showing that the preorganization requirements had not been met.<sup>44</sup>

In a certain case,<sup>45</sup> it appeared that at the time a producer signed a marketing agreement with a cooperative, it was understood that the marketing agreement was not to become effective until the expiration of a prior contract with a commercial distributor, and, therefore, the association could not regard the producer as a member for all purposes and could not enforce the marketing agreement against him.

In an Illinois case<sup>46</sup> in which the contract was not to become effective unless 55 percent of the grain producers in the "township or trade territory" signed the marketing contract, it was contended that this term was ambiguous and uncertain and that the contract was consequently void, but the court held that the term "township or trade territory" was not ambiguous since under the bylaws the boundaries of the territory were to be determined by the association.

If the contract specifies that a notice advising that the required sign-up has been effected will be mailed to each producer signing the contract and the notice is not mailed, the contract is not effective<sup>47</sup> unless notice is waived.<sup>48</sup>

In a Tennessee<sup>49</sup> case, it was said:

Complainant and defendant having agreed that the contract should be treated as accepted by complainant as of the date of mailing such notice, and the fact of acceptance by the association deemed conclusive upon the mailing of the notice, it must be held that the contract became effective on the date that the notice was mailed to defendant, and not before.

A contract may specify that public notice shall be given when the required sign-up is effected, and then notice may be given in the public press of the district.

Ordinarily it would appear preferable to have the contract so drawn that it is effective and binding from the signing thereof but subject to cancellation in the event the required sign-up is not effected by a certain time. In this way questions regarding the status of the contract prior to the giving of the notice that the necessary sign-up has been obtained are eliminated.

In preparing marketing agreements which are to become effective only upon the happening of prescribed conditions, care should be exercised to employ a simple, clear and conclusive procedure for making the required determination.

<sup>43</sup> *Kansas Wheat Growers' Association v. Bridges*, 133 Kan. 397, 1 P. 2d 265.

<sup>44</sup> *Kansas Wheat Growers' Association v. Windhorst*, 129 Kan. 528, 283 P. 638, 131 Kan. 423, 292 P. 777, 132 Kan. 21, 294 P. 928.

<sup>45</sup> *Cooperative Dairymen's League v. Hansen*, 23 Cal. App. 2d 493, 73 P. 2d 627.

<sup>46</sup> *Farmers' Educational and Cooperative Union of America, Illinois Division v. William Langlois*, 258 Ill. App. 522.

<sup>47</sup> *Idaho Grimm Alfalfa Seed Growers' Association v. Stroschein*, 42 Idaho 12, 242 P. 444, 47 A. L. R. 916.

<sup>48</sup> *Wenatchee Dist. Coop. Association v. Thompson*, 143 Wash. 657, 255 P. 918.

<sup>49</sup> *Dark Tobacco Growers' Coop. Association v. Mason*, 150 Tenn. 228, 263 S. W. 60, 66.

## Duration of Marketing Contracts

For what period of time may a cooperative marketing contract be entered into? Many cooperative statutes<sup>50</sup> prescribe the maximum number of years, frequently 10, that may be covered in a contract, and if the statute under which an association is formed contains such a provision it should be observed. If there is no restrictive provision on the subject in the law of the State or the charter of the association, then an association and its members are free to enter into marketing contracts for any period that may be agreed upon.

Provisions may be inserted in marketing contracts (unless the length of time a contract may run is restricted by law or by the charter of the association) providing that the contract shall continue from year to year unless canceled on or before a certain date.

In some instances cooperatives attempt to make their marketing contracts continuous although the statutes under which the associations are incorporated prescribe maximum periods such contracts may run.

In a Washington case<sup>51</sup> the statute restricted the period for which marketing contracts might run to 10 years and the contract provided that it should run—

for a period of 10 years from the date hereof, and from year to year thereafter continuously; Provided, however, that the dairyman may cancel this contract 2 years after the date hereof by giving notice in writing to the association, \* \* \*.

With respect to the contention that the marketing agreement was invalid because it exceeded the 10-year restriction, the court said:

Clearly the contract here under consideration is good for a period of ten years from its date and whether or not the language which purports to continue it in effect thereafter is binding cannot in any way affect the present situation. If that language be ineffectual, then it is surplusage only, and surplusage does not vitiate. If it be effectual, the courts will enforce it when the time comes. In the meantime, the act may be repealed or amended, and we cannot undertake to decide questions which may never arise.

The holding in the foregoing case is believed to be sound, particularly as the provision in the Washington statute, like such provisions generally, did not provide that marketing contracts which exceed the statutory limitation are void. It has been held that a third person may not successfully contend that marketing agreements are void "because they were not made to terminate within 10 years as provided in the statute," and that "the claim that the agreements are ultra vires can be raised only by the State or by some member of the complainant association."<sup>52</sup>

Cases arising under statutes which declare invalid contracts or leases made for a period in excess of that specified by statute are not directly in point in determining the validity of marketing contracts which exceed the statutory period;<sup>53</sup> but in some instances instruments which exceeded the statutory period therefor, although the statute did not provide that they were invalid, have been held void.<sup>54</sup>

<sup>50</sup> See sec. 17 of Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>51</sup> *Olympia Milk Producers' Association v. Herman*, 176 Wash. 338, 29 P. 2d 676, 678. See also *Robertson v. Hayes*, 83 Ala. 290, 3 So. 674; *McCullough v. Smith*, 243 F. 823.

<sup>52</sup> *Local Dairymen's Cooperative Association v. Potvin*, 54 R. I. 430, 173 A. 535.

<sup>53</sup> *Waldo v. Jacobs*, 152 Mich. 425, 116 N. W. 371, 15 Ann. Cas. 343; *Wegner v. Lubenow*, 12 N. D. 95, 95 N. W. 442.

<sup>54</sup> *Perry v. Missouri-Kansas Pipe Line Company*, 191 A. 823 (Del. Ch.).



It is believed that if it is desired to provide for the continuation of a contract beyond the statutory period therefor, it should be possible to accomplish this purpose through provision that if the parties fail to terminate the contract during a specified period each year this fact shall operate to renew the same, thus making the contract one from year to year. This would not appear to be in derogation of the statute but in recognition thereof.

In a Colorado case<sup>55</sup> it was said:

Defendant association enters into a separate agreement with each of its members, by which he constitutes it his sole agent for the purpose of marketing and contracting for sale all sugar beets to be grown by him or for him within the state during each year, and from year to year thereafter, subject to the right of either party to the contract, at the end of any year, by written notice delivered to the other party on or before November 1 of each year, to terminate the same. In legal effect it is a 1-year contract at the option of either party.

The Cooperative Marketing Act of Colorado, under which this association was incorporated, restricted the period for which a marketing contract might be entered into to 10 years. Failure to terminate such a contract would appear to be the equivalent of a renewal thereof as the contract remains in effect only because the parties will that it shall do so; and such a contract does not appear to be contrary to statutory provisions restricting the period for which marketing contracts may be made.

In the case just referred to, a sugar company, the only buyer of sugar beets in the territory, refused to enter into a contract with the association because of a stipulation requiring the sugar company to make another contract for 3 additional years. The court expressed the view that, since the contract of the association with its members covered only the production of 1 year, the association was not in a position to insist that purchasers of the members' crops obligate themselves to accept these crops over a period of 4 years; and that, under the circumstances, a member was entitled to have his marketing contract with the association canceled.

With respect to the right to renew a contract in the manner outlined above, the following is pertinent:

The parties made their own contract, and we perceive no reason why they could not provide for extensions of the life of the contract, without further notice to defendant, if they saw fit to so agree at the time they made such contract. Such an agreement, so far as we know, violates no settled principle of law or public policy.<sup>56</sup>

Provision in a marketing contract permitting a member or the association to terminate it is valid. Such provisions, insofar as the members are concerned, are usually referred to as withdrawal provisions. A provision authorizing either party to terminate a contract does not affect its binding character. It affects only the length of time the contract may run. Unless the conditions for the termination of a contract are met, however, the cancellation of the contract concerned is not effected. In other words, there is no termination unless conditions relative thereto are complied with. For instance, if a withdrawal provision permits a member to withdraw by giving 30 days' notice prior to a certain day, a notice that fails to give the full 30 days is void and the attempt to withdraw fails.<sup>57</sup>

<sup>55</sup> *Mountain States Beet Growers' Marketing Association v. Monroe*, 84 Colo. 300, 269 P. 886, 887. See also *Loomis Fruit Growers' Association v. California Fruit Exchange*, 128 Cal. App. 265, 16 P. 2d 1040.

<sup>56</sup> *Yerxa, Andrews & Thurston v. Randazzo Macaroni Manufacturing-Company*, 315 Mo. 927, 288 S. W. 20, 33.

<sup>57</sup> *Mosher Grain v. Kansas Coop. Wheat Marketing Association*, 136 Kan. 269, 15 P. 2d 421; *Grays Harbor Dairyman's Association v. Engen*, 130 Wash. 169,

It is generally recognized that if an agreement provides the terms and conditions under which it may be canceled this method is exclusive.<sup>58</sup>

The period for which the marketing agreements of an association may run without a right on the part of producers to terminate them may become important in the enforcement of such contracts because, if marketing agreements are terminated while a suit to enjoin the violation of them is pending, the suit will be dismissed; and, if the marketing agreements may be terminated by the producers so as to virtually nullify the effect of an injunction prohibiting their breach, such relief may be denied.<sup>59</sup>

### Signing Marketing Contracts

Even though a contract is signed without being read by persons capable of reading it, and although the claim is made that its contents were misrepresented, it is valid and enforceable if signed under normal conditions.<sup>60</sup> The law proceeds upon the theory that a person must use some care and caution to protect himself and that he cannot complain of situations made possible by his own carelessness.

If the signer of a contract is illiterate and the contract is misrepresented to him it may be rescinded.<sup>61</sup> If a contract is signed with the understanding that it is not to become effective until the happening of a certain event, such as obtaining the approval of a third person, the contract fails if the approval is not obtained,<sup>62</sup> or if the delivery of the contract was conditional and the grower was to have an opportunity of reading it before the contract became effective, it fails if this opportunity is not given.<sup>63</sup> Close questions of fact may arise under circumstances like these, and in a Virginia case the court refused to believe testimony that the contract had been conditionally delivered and hence held it binding.<sup>64</sup>

A wife or husband is not by virtue of the marriage relationship alone the agent of the other to sign a marketing contract;<sup>65</sup> but if either had been given or had been represented by the other as having authority to market the crops grown, a marketing contract signed by the husband or the wife, as the case might be, would be binding on the other.<sup>66</sup>

### Contracts Obtained by Force or Fraud

If solicitors, in seeking to get producers to sign contracts, make statements which are material and false relating to the affairs of the association,

226 P. 496; *Egyptian Seed Growers' Exchange v. Hollinger*, 238 Ill. App. 178; *Meyer v. California Prune & Apricot Growers' Association*, 42 Cal. App. 2d 632, 109 P. 2d 726. But see *Taresh v. California Canning Peach Growers*, 3 Cal. 2d 686, 45 P. 2d 964.

<sup>58</sup> *Meyer v. California Prune & Apricot Growers' Association*, 42 Cal. App. 2d 632, 109 P. 2d 726.

<sup>59</sup> *Pure Milk Producers' Association of Greater Kansas City Territory v. Bridges*, 146 Kan. 15, 68 P. 2d 658.

<sup>60</sup> *Pittman v. Tobacco Growers' Coop. Association*, 187 N. C. 340, 121 S. E. 634; *Tobacco Growers' Coop. Association v. Chilton*, 190 N. C. 602, 130 S. E. 312; *Barron G. Collier, Inc. v. Stebbins*, 236 Mich. 147, 210 N. W. 264.

<sup>61</sup> *Dunbar v. Tobacco Growers' Coop. Association*, 190 N. C. 608, 130 S. E. 505; *Simpson v. Tobacco Growers' Coop. Association*, 190 N. C. 603, 130 S. E. 507.

<sup>62</sup> *Tobacco Growers' Coop. Association v. Battle*, 187 N. C. 260, 121 S. E. 629.

<sup>63</sup> *Georgia Cotton Growers' Coop. Association v. Smith*, 163 Ga. 761, 137 S. E. 233.

<sup>64</sup> *Elmore v. Maryland & Virginia Milk Producers' Association, Inc.*, 145 Va. 42, 132 S. E. 521, 134 S. E. 472.

<sup>65</sup> *Waken v. Davis*, 112 Okla. 23, 239 P. 659; *Sladkin v. Ruby*, 103 N. J. Law 449, 135 A. 880.

<sup>66</sup> *Dark Tobacco Growers' Coop. Association v. Garth*, 218 Ky. 391, 291 S. W. 367.

contracts thus obtained may be set aside by the producers in suits promptly brought for this purpose. Also if such producers after discovery of the fraud promptly give notice to the association that they regard the contracts as invalid because of fraud and then refuse to recognize them in any way, they may defend suits brought against them by the association for failure to abide by the contracts by showing fraud in their procurement.<sup>67</sup> Probably in some jurisdictions, although no notice of the fraud was given by the producers to the association, they could defend suits brought against them by the association by showing fraud in the procurement of the contracts.<sup>68</sup>

If duress, force, or intimidation is used to obtain a contract, the producer concerned may have it set aside or may defend when sued thereon, by showing the facts under which it was obtained.<sup>69</sup>

In California the failure to exhibit a permit issued under the blue sky laws of that State, and as required by such laws, to a prospective member was held to constitute fraud and to justify the cancelation of the marketing contract entered into with a producer.<sup>70</sup>

Although force or fraud is involved in the procurement of a contract, if the producer recognizes the contract in any way after discovery of the fraud or the cessation of the force such as by making deliveries under it, or if he executes a proxy, thus asserting that he is a member of the association, when membership, if it exists, is by reason of the marketing contract or as a part thereof, or if by any other act a producer recognizes the contract as binding although procured by force or fraud, he will be deemed to have waived the force or fraud, as the case may be, and the contract may be enforced against him.<sup>71</sup>

For statements made by solicitors or others in the procurement of contracts to amount to such fraud or misrepresentation as would authorize a rescission of a contract, the statements made must relate either to past or to present conditions or situations affecting the association, because a prophecy made or opinion expressed as to the things that will be accomplished by the association are all matters in the realm of conjecture, and whether they will or will not come to pass is known by all concerned to be uncertain.<sup>72</sup> In some jurisdictions, however, parties making statements, or expressing opinions concerning the future must honestly believe them.<sup>73</sup>

If the person to whom false statements are made to induce him to sign a contract knows that the statements are false, he cannot rescind the contract because of them.<sup>74</sup> Oral statements or agreements made prior to the

<sup>67</sup> *Kansas Wheat Growers' Association v. Vague*, 118 Kan. 246, 234 P. 964; *Kansas Wheat Growers' Association v. Massey*, 123 Kan. 183, 253 P. 1093; *Kansas Wheat Growers' Association v. Rowan*, 123 Kan. 169, 254 P. 326; *Burley Tobacco Growers' Coop. Association v. Rogers*, 88 Ind. App. 469, 150 N. E. 384; *Placentia Coop. Orange Growers' Association v. Henning*, 118 Cal. App. 487, 5 P. 2d 444.

<sup>68</sup> For a discussion of fraud in the procurement of stock subscriptions see p. 44.

<sup>69</sup> *Sun-Maid Raisin Growers of California v. Papazian*, 74 Cal. App. 231, 240 P. 47; *Commonwealth (Burley Tobacco Society) v. Reffitt*, 149 Ky. 300, 148 S. W. 48, 42 L. R. A. (N. S.) 329.

<sup>70</sup> *Klombies v. Weeks Poultry Community, Inc.*, 121 Cal. App. 175, 8 P. 2d 940.

<sup>71</sup> *Kansas Wheat Growers' Association v. Massey*, 123 Kan. 183, 253 P. 1093; *Kansas Wheat Growers' Association v. Rowan*, 123 Kan. 169, 254 P. 326; *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 147 Ore. 503, 30 P. 2d 344; *Beaulaurier v. Washington State Hop Producers, Inc.*, 8 Wash. 2d 79, 111 P. 2d 559.

<sup>72</sup> *South Carolina Cotton Growers' Coop. Association v. English*, 135 S. C. 19, 133 S. E. 542; *Burley Tobacco Growers' Coop. Association v. Rogers*, 88 Ind. App. 469, 150 N. E. 384; *Hilgendorf v. Schuman*, 232 Wis. 625, 288 N. W. 184.

<sup>73</sup> *Texas Farm Bureau Cotton Association v. Craddock*, 285 S. W. 949 (Tex. Civ. App.); *Dunbar v. Tobacco Growers' Coop. Association*, 190 N. C. 608, 130 S. E. 505.

<sup>74</sup> *Simpson v. Tobacco Growers' Coop. Association*, 190 N. C. 603, 130 S. E. 507.



signing of a marketing contract regarding matters covered therein are merged in the written contract, and although inconsistent with the terms of the contract they may not be used for upsetting the contract.<sup>75</sup>

### When Title to Products Passes to the Association

When does title to the products covered by a purchase-and-sale contract pass to an association? May an association take title to the fruit, grain, wool, or other agricultural product covered by its marketing contract prior to the time when the producer delivers the product to the association? The parties to a contract are free to include therein any terms they wish with respect to the passing of title and the rights and responsibilities of each in relation to the products involved. For instance, a contract may provide that the title to products passes to the association before delivery of them, but that the risks incident to their holding, handling, and delivery are the producer's.<sup>76</sup>

As between the parties to a marketing contract there is apparently no question that the contract may be so drawn as to pass title to the association before the producer has delivered the products.<sup>77</sup> Many cooperative statutes expressly authorize the making of marketing contracts that pass title to the products involved prior to delivery to the associations formed under them. In many cooperative statutes language reading substantially as follows appears: "If they (members) contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery; or at any other specified time if expressly and definitely agreed in the said contract."<sup>78</sup> This language expressly authorizes the making of marketing contracts that pass title to products prior to their delivery to an association. Obviously, a "purchase" of products after their sale to an association is not a recorded lien.

In order to have the marketing contract pass title to the products covered by it, prior to the time when the products are delivered to the association, the marketing contract should read so as to make plain that it is a contract of sale rather than a contract to sell. If the marketing contract reads that the producer agrees to sell and the association agrees to buy, this language standing alone is generally construed to imply an executory contract as distinguished from an executed contract. In a North Carolina case, the court passed upon a marketing contract which read, "The association agrees to buy and the grower agrees to sell and deliver" the tobacco in question, and held that this was a contract to sell rather than a contract of sale.<sup>79</sup>

A question<sup>80</sup> arose as to the meaning of a provision in a marketing con-

<sup>75</sup> *Burley Tobacco Growers' Coop. Association v. Rogers*, 88 Ind. App. 469, 150 N. E. 384; *Natchez Pecan Marketing Association v. Bramlett*, 163 Miss. 596, 143 So. 429.

<sup>76</sup> *California Grape Control Board, Ltd. v. Boothe Fruit Company*, 220 Cal. 279, 29 P. 2d 857; *Elgee Cotton Cases*, 89 U. S. 180, 22 L. Ed. 863; *Filiatreau v. United States*, 14 F. 2d 659. But see *Colorado-New Mexico Wool Marketing Association v. Manning*, 96 Colo. 186, 40 P. 2d 972.

<sup>77</sup> *Sun-Maid Raisin Growers of California v. Jones*, 96 Cal. App. 650, 274 P. 557, hearing denied by State Supreme Court; *Texas Hay Association v. Angleton State Bank*, 291 S. W. 846 (Tex. Com. App.), reversing 285 S. W. 941; *Beardsley v. Beardsley*, 138 U. S. 262, 11 S. Ct. 318, 34 L. Ed. 928; 24 R. C. L. sec. 312; *California Canning Peach Growers v. Corcoran*, 14 Cal. App. 2d 264, 57 P. 2d 1360.

<sup>78</sup> See sec. 17 of Bingham Cooperative Market Act of Kentucky, p. 305 of Appendix.  
<sup>79</sup> *Tobacco Growers' Coop. Association v. Harvey & Son Co.*, 189 N. C. 494, 127 S. E. 545, 47 A. L. R. 928.

<sup>80</sup> *Lennox v. Texas Farm Bureau Cotton Association*, 16 S. W. 2d 413, 421 (Tex. Civ. App.).

tract requiring the grower "to sell and deliver to the association all the cotton produced or acquired by or for him \* \* \*." The court said—

to enable a grower to deliver to the association cotton "acquired" by him the acquisition must be full and complete, not only of the title, but of the right of possession, as well, unhampered by any restrictions. Until the grower attains that status, he has never "acquired" the cotton, so as to enable him to comply with his contract. To "acquire" cotton for delivery means to acquire the legal right and power to make a delivery.

Because the tenants from whom the grower had purchased the cotton had delivered the cotton to warehouses and taken therefor receipts which they turned over to a bank which then made loans on the cotton to the grower to enable him to make advances to the tenants, it was held that the grower had not acquired possession of the cotton inasmuch as the right to possession was in the bank from which the loans had been obtained and, therefore, the grower could not be compelled by specific performance to deliver this cotton.

In a Colorado case,<sup>81</sup> apparently because of the form of marketing agreement, the Court held that the rights of the association with respect to the wool covered by the marketing contract were junior to those of third persons.

Assuming that a marketing contract is a contract of sale and one under which the title passes prior to the time when the products are delivered to the association, does the association concerned receive such a title to the products that any dealer or other person "buying" the products after the making of the marketing contract cannot get title to them? If the products are seized by a creditor of the producer or if a person takes a chattel mortgage on them after the making of the marketing contract, are the rights of the association to the products superior to the rights of such creditors? In a majority of the States, an association concerned in a situation like any of those described would apparently have title to the products so that the association could recover damages (or the products) from any dealer who attempted to purchase them, or from any person who attempted to attach or seize them as the products of the producer, or from any person who was seeking to enforce a chattel mortgage on the products taken after their sale to the association.

In a California case,<sup>82</sup> raisins grown by a producer who had entered into a marketing contract with the Sun-Maid Raisin Growers of California were seized by the sheriff while they were in sweat boxes and before their delivery to the association, to satisfy a judgment which had been obtained by a creditor against the grower of the raisins. The Sun-Maid Raisin Growers of California then brought suit against the sheriff for the recovery of the raisins. The court held that title to the raisins was in the association at the time the sheriff seized them, and hence that the raisins could not be used to satisfy the claim which the creditor had against the grower. In determining that title had passed, the court emphasized the fact that the contract provided:

That the buyer (Sun-Maid Raisin Growers, a corporation) does hereby purchase and the seller (Betel) does hereby sell all of the raisin grapes to be produced during

<sup>81</sup> *Colorado-New Mexico Wool Marketing Association v. Manning*, 96 Colo. 186, 40 P. 2d 972.

<sup>82</sup> *Sun-Maid Raisin Growers of California v. Jones*, 96 Cal. App. 650, 274 P. 557, 558, 559, hearing denied by the State supreme court; *Merriman v. Martin*, 113 Cal. App. 167, 298 P. 95. See also *Texas Hay Association v. Angleton State Bank*, 291 S. W. 846 (Tex. Com. App.), reversing 285 S. W. 941.

the years 1923 to 1937, inclusive. \* \* \* This instrument is intended by the parties to pass to and vest in the buyer a present title and right of possession to all of the crops of raisin grapes covered hereby. The buyer shall at all times have the right to enter upon said premises and remove the said crops therefrom; but the right of the buyer to so enter and remove said crops shall not affect the obligation of the seller to pick, cure and deliver the same as above provided.

The Court said:

Title passed when first the raisin grapes became property which could be the subject of ownership and sale. A potential existence of the grapes seems to answer this requirement. *Arques v. Wasson*.<sup>83</sup> This, of course, was long before the attachment which was levied upon a portion of the crop while in "sweat boxes" undergoing the final curing process. When the grower's creditor, therefore, attached the raisin grapes or the raisins, whichever they were at the time of the levy, they belonged to respondent.

When a cooperative took title to grapes on the vines and posted notice of purchase in the vineyard of the grower, it was held that the association could recover actual and exemplary damages from a corporation which, through its president, converted a portion of the grapes; and it was held that the claim that the association—

suffered no damage because it intended to violate the state law by allowing the grapes to waste on the vines clearly cannot be relied upon by appellant.<sup>84</sup>

Under the optional-pool plan of handling cotton, a stipulation in the marketing contract of a cooperative under which a member had the option "to determine when the price on his cotton will be fixed" was held not to be in conflict with a provision in the marketing contract providing that title to the cotton should pass to the association on its delivery.<sup>85</sup>

Even though title to commodities has passed to an association this does not affect the obligation of the association to account to its members in accordance with the terms of the marketing contract. In this connection the following quotation from a Texas case<sup>86</sup> is significant:

It being the clear intention of the members to create a true cooperative marketing association, under the powers enumerated by law and by the contracts, to perform certain services exclusively for its members, and to hold in the face of this intention that the delivery of the seed to the association was an absolute sale would destroy it as a cooperative marketing association. The members have conferred on this association, as their selling agent, such title to the cottonseed with plenary powers to handle and dispose of same, but the association handles the proceeds thereof for the benefit of itself and its members.

It is true that at common law, as declared in some of the States, the sale of a commodity then capable of delivery, without its delivery to the buyer, is either conclusive or presumptive evidence of fraud if, subsequent to the sale, third parties in good faith acquire rights therein;<sup>87</sup> but the common law rule just stated is held to have little or no application in cases involving the sale of crops to be grown.<sup>88</sup> This conclusion is apparently based upon the fact that a lawful contract may be made for the sale of crops to be

<sup>83</sup> *Arques v. Wasson*, 51 Cal. 620, 21 Am. Rep. 718.

<sup>84</sup> *California Grape Control Board, Ltd. v. Boothe Fruit Company*, 220 Cal. 279, 29 P. 2d 857, 858.

<sup>85</sup> *Burch v. South Carolina Cotton Growers' Coop. Association*, 181 S. C. 295, 187 S. E. 422.

<sup>86</sup> *Texas Certified Cottonseed Breeders' Association v. Aldridge*, 122 Tex. 464, 61 S. W. 2d 79, 83, reversing 59 S. W. 2d 320 (Tex. Civ. App.).

<sup>87</sup> 24 R. C. L. sec. 312.

<sup>88</sup> *Bellows v. Wells*, 36 Vt. 599; *McCarty v. Blevins*, 13 Tenn. 195, 26 Am. Dec. 262; *Hull v. Hull*, 48 Conn. 250, 40 Am. Rep. 165; 24 R. C. L. sec. 315; *Lieberman v. Knight*, 153 Tenn. 268, 283 S. W. 450.



grown<sup>89</sup> and, as the crop is not then in existence, its delivery at the time of sale is manifestly impossible.<sup>90</sup>

In many of the States, statutes have been passed making the retention of possession of goods sold by the seller either presumptive or conclusive<sup>91</sup> evidence of fraud as to third persons subsequently acquiring rights in the property sold. Generally, such statutes are so drawn that they have no application to the sale of growing crops or crops to be grown. For instance, in the case cited above, involving the Sun-Maid Raisin Growers of California, it was urged that the sale of the raisins was void because of the statute of California requiring the delivery of property sold, but the court pointed out that this statute only declares that transfers of property without the delivery thereof are void "if made by a person having at the time the possession or control of the property." Obviously, at the time the marketing contract covering the raisins was signed the grower did not have possession or control of the grapes which had not then been grown.<sup>92</sup>

In Oregon the Uniform Sales Act provides in part:

Where a person having sold goods continues in possession of the goods, or of negotiable documents of title to the goods, the delivery or transfer by that person, or by an agent acting for him, of the goods or documents of title under any sale, pledge, or other disposition thereof, to any person receiving and paying value for the same in good faith and without notice of the previous sale, shall have the same effect as if the person making the delivery or transfer, were expressly authorized by the owner of the goods to make the same.

Under this Act, it was held that, when a dealer bought of a member of a cooperative wool which the member was obliged to deliver to the association under a marketing agreement that on its face passed title to the wool to the association, the dealer acquired good title to the wool inasmuch as the dealer did not have notice of the marketing agreement.<sup>93</sup>

Some of the State statutes relative to the retention of possession of goods sold by the seller make the retention of such possession merely presumptive evidence of fraud as to third persons. In a Minnesota case, referring to such a statute, the court said:

It provides in express terms that such possession shall be presumed to be fraudulent and void as against subsequent purchasers in good faith, unless those claiming under such sale make it appear that the sale was made in good faith and without any intent to defraud such purchasers.<sup>94</sup>

In this case a person purchased an automobile and allowed the machine to continue in the possession of the seller, who subsequently borrowed money on the machine, giving as security a chattel mortgage thereon. The buyer of the automobile brought suit against the person who claimed it under the chattel mortgage and, as the court found that the buyer of the automobile had acted in good faith, the buyer won.

Either by reason of statutes or by decisions of the courts, many States

<sup>89</sup> *Dickey v. Waldo*, 97 Mich. 255, 56 N. W. 608, 23 L. R. A. 449.

<sup>90</sup> 24 R. C. L. sec. 315; *Bellows v. Wells*, 36 Vt. 599.

<sup>91</sup> *Brown v. Herrick*, 34 Idaho 171, 200 P. 117.

<sup>92</sup> *Sun-Maid Raisin Growers of California v. Jones*, 96 Cal. App. 650, 274 P. 557, hearing denied by the State supreme court. See also *Bloom v. Welsh*, 27 N. J. Law 177; *Flynt v. Conrad*, 61 N. C. 190, 93 Am. Dec. 588; *Cook v. Steel*, 42 Tex. 53.

<sup>93</sup> *Pacific Wool Growers v. Draper & Co.*, 158 Ore. 1, 73 P. 2d 1391, 1393.

<sup>94</sup> *Wilson v. Walrath*, 103 Minn. 412, 115 N. W. 203, 204, 24 L. R. A. (N. S.) 1127. See also *Kimball v. Cash*, 176 N. Y. S. 541, 107 Misc. Rep. 363; *Godman v. Olson*, 38 N. D. 360, 165 N. W. 515.

have adopted the rule that the retention of possession of goods sold by the seller is only presumptive evidence of fraud as to third persons.<sup>95</sup>

The common law rule, in some States, made the retention of the possession of goods sold void as to third persons. The rule, apparently, at common law had no application to growing crops and this common law, as well as the rules prescribed by statutes of frauds, is generally not applicable to growing crops.

Again at common law and under statutes, as a general rule, if a third person subsequent to the sale of goods (the possession of which is retained by the seller) has notice of the fact that the goods have previously been sold, his rights are junior to the rights of the person who purchased the goods in the first instance, and under these circumstances the fact that there has been no actual delivery of the goods is immaterial;<sup>96</sup> for the general rule is that "A purchaser with notice of a prior contract to sell or to lease takes subject to such contract, and is bound in the same manner as his vendor to carry it into execution; \* \* \*"<sup>97</sup>

In view of the state of the law as indicated above, persons who buy farm products from producers who have entered into marketing contracts with their associations to sell such products to the association, run a great risk in doing so, even though they may be unaware of the marketing contract of the association; because it will be remembered that, if title to the products covered by a marketing contract has passed to the association, an association may be able to recover damages or the products from any person acquiring the same from a producer without its consent.

The foregoing discussion is entirely independent of the statutes that have been passed in some States providing for the filing or recording of marketing contracts of cooperatives, for the purpose of giving notice to the world of the rights of an association under them. If such a statute has been passed in a State, third persons are undoubtedly bound who attempt to purchase or acquire liens on the products of members after the filing or recording of the marketing contracts.

In Arizona,<sup>98</sup> New Mexico,<sup>99</sup> Oregon,<sup>1</sup> South Carolina,<sup>2</sup> Virginia,<sup>3</sup> and

<sup>95</sup> *Shaul v. Harrington*, 54 Ark. 305, 15 S. W. 835; *Holliday v. McKinne*, 22 Fla. 153; *Osborn v. Ratliff*, 53 Iowa 748, 5 N. W. 746; *Gardiner Bank v. Hodgdon*, 14 Me. 453; *Brooks v. Powers*, 15 Mass. 244, 8 Am. Dec. 99; *Johnston v. Dick, Hill & McLean*, 27 Miss. 277; *Rea v. Alexander*, 27 N. C. 644; *Hombeck v. Vanmetre*, 9 Ohio 153; *Benjamin v. Madden*, 94 Va. 66, 26 S. E. 392; *Poling v. Flanagan*, 41 W. Va. 191, 23 S. E. 685; *Fitzgerald v. Meyer*, 25 Neb. 77, 41 N. W. 123; *Williams v. Brown*, 137 Mich. 569, 100 N. W. 786; *Prentiss Tool & Supply Co. v. Schirmer*, 136 N. Y. 305, 32 Am. St. Rep. 737, 32 N. E. 849; *Patterson Co. v. People's Loan and Savings Co.*, 158 Ga. 503, 123 S. E. 704.

<sup>96</sup> *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391; *Hatch v. Oil Co.*, 100 U. S. 124, 25 L. Ed. 554; *Clark v. Shannon & Mott Co.*, 117 Iowa 645, 91 N. W. 923; *Bridgham v. Hinds*, 120 Me. 444, 115 A. 197, 21 A. L. R. 1024; *Dieckman v. Young*, 87 Mo. App. 530; 35 Cyc. 304, 345.

<sup>97</sup> *Pomeroy's EQUITY JURISPRUDENCE*, 3d ed., sec. 688, p. 1385; *Union Pacific Railway Co. v. McAlpine*, 129 U. S. 305, 9 S. Ct. 286, 32 L. Ed. 673; *Gore v. Condon*, 82 Md. 649, 33 A. 261. See also *California Grape Control Board, Ltd. v. Boothe Fruit Company*, 220 Cal. 279, 29 P. 2d 857; *Pacific Wool Growers v. Draper & Co.*, 158 Ore. 1, 73 P. 2d 1391.

<sup>98</sup> Arizona Code Ann. 1939, sec. 49-714.

<sup>99</sup> New Mexico Statutes Ann. 1953, sec. 61-5-5 n.

<sup>1</sup> Oregon Revised Statutes 1953, sec. 62.150.

<sup>2</sup> Code of Laws of South Carolina 1952, sec. 60-352.

<sup>3</sup> Code of Virginia 1950, sec. 13-280.

Wisconsin,<sup>4</sup> provision has been made for the filing or recording of marketing contracts for the purpose of giving notice to all concerned of the rights of the association with respect to the crops covered by marketing contracts.

The cooperative marketing act of Indiana<sup>5</sup> provides that—

Growers of agricultural products who have signed any such marketing agreement with cooperative marketing associations organized hereunder shall be permitted to place crop mortgages upon their crops; but said crop mortgages and any other liens shall be subordinate to the right of such association to take delivery of any such crops covered by the marketing agreement.

### Restrictions on Association's Right To Sell

If an association receives commodities to sell subject to certain restrictions such as that all sales are to be approved by the member, or that no sales will be made before a certain date, these restrictions should be observed if the association is to avoid risk of liability. The question arises whether an association may ever sell goods in its possession, if to do so would be contrary to an agreement which the association has made.

In a Texas case<sup>6</sup> a cooperative had entered into a written contract with a member, under which the association had the authority to sell the cotton delivered pursuant thereto, but later the association entered into an oral understanding with the member that it would not "sell the 1,095 bales of cotton without first consulting" the member "as to the price to be paid therefor." The association sold the cotton without first consulting the member and the member recovered a judgment against the association because of its failure to abide by its oral agreement.

If a factor receives a consignment of goods to be sold subject to restrictions as to price or terms of sale and he makes advances on the goods or incurs expenses with respect thereto, it is generally held that he may proceed to sell the goods if the consignor, after reasonable notice, fails to reimburse the factor for the advances or the expenses incurred.<sup>7</sup> No reason is apparent why under comparable circumstances an association could not sell commodities which it had received from its members for sale, if the members after reasonable notice, failed to reimburse the association. It may be that in a particular case the terms of the marketing contract of an association might alter the situation; but, generally, it is believed that an association is entitled to sell commodities for the purpose of reimbursing itself under conditions where a factor might do likewise.

In the interest of operating efficiency an association should have broad powers of sale; and, in general, restrictions on its authority to make sales should be avoided. Some associations which operate on a pool basis include provisions in their marketing contracts which specifically authorize them to set a value on the residue of commodities which are on hand at the

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<sup>4</sup> Wisconsin Statutes 1953, sec. 185.08, replaced by sec. 185.52 after June 30, 1956, Wis. Laws 1955, c. 368, p. 435 et seq.; construed in *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391. See also *Spencer Cooperative Live Stock Shipping Association v. Schultz*, 209 Wis. 344, 245 N. W. 99; *Wisconsin Cooperative Milk Pool v. Saylesville Cheese Manufacturing Company*, 219 Wis. 350, 263 N. W. 197; *Neillsville Shipping Association v. Lastofka*, 225 Wis. 350, 274 N. W. 280.

<sup>5</sup> Burns Indiana Statutes Ann., sec. 15-1615 (d).

<sup>6</sup> *Texas Cotton Cooperative Association v. Lennox*, 55 S. W. 2d 543 (Tex. Com. App.), reversing 37 S. W. 2d 331. See also *Imperial Valley Long Staple Cotton Growers' Association v. Davidson*, 58 Cal. App. 551, 209 P. 58; *Sullivan v. American Fruit Growers, Inc.*, 45 Idaho 153, 260 P. 1029.

<sup>7</sup> *Brown v. Southern Grocery Company*, 168 Ark. 547, 271 S. W. 342, 40 A. L. R. 383. See note in 40 A. L. R. 387.



close of a marketing period and to account to their members accordingly. Thus an association is enabled to make a final settlement for a crop although a portion may not have been sold. Such an authority should be carefully and conservatively exercised.

## Pooling

Pooling is widely practiced by cooperatives. Pooling should be thought of as an averaging process, an averaging with respect to products, prices, expenses, or returns. In the case of products, this involves a grading of the products received from each member and a separation of such products according to grade for sale purposes. If the pool is a seasonal one, when all the products received from the members for a given crop year have been sold, the quantity that each member has had in each grade is multiplied by the average price per unit received for all the products in that grade, and thus the total amount that each member is entitled to receive after the deduction of marketing expenses and any other authorized deductions is determined.

Daily, weekly, monthly, or seasonal pools, if authorized, could be established; or the pool might consist of a single shipment, say of livestock; but the principles underlying all such pools are the same. Generally, in long-time pools, one or more advances may be made to members after the receipt of the products, and then final settlement is made after the sale of all the products in the pool and after it is known what the total expenses of the association for the year will be.

Marketing expenses are pooled either on the basis of units of product or on the basis of value. Marketing expenses, even when products are pooled for periods of less than 1 year, are often on a yearly basis. This is fair, as expenses continue throughout the year and the association must be maintained. Broadly speaking, any pooling method for any of these things is valid provided the members have consented thereto<sup>8</sup> either in the bylaws or in the contract.

The right of an association to determine conclusively the grade of products received from its members, if authorized to do so by its bylaws or marketing contract, is established.<sup>9</sup>

The question whether pooling or grading is properly done appears to be open only in case of fraud or such gross mistake as to imply bad faith.<sup>10</sup>

Unless an association is authorized to pool products or expenses or gains or losses, it may not do so. In an Oregon case involving a milk association, the cooperative attempted to apportion losses arising from the fact that

<sup>8</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190; *Washington Coop. Egg & Poultry Association v. Taylor*, 122 Wash. 466, 210 P. 806; *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231; *Martinsburg & Potomac Railroad Co. v. March*, 114 U. S. 549, 5 S. Ct. 1035, 29 L. Ed. 255; *Kelsey v. Early Grain & Elevator Company*, 206 S. W. 849 (Tex. Civ. App.).

<sup>9</sup> *Washington Coop. Egg & Poultry Association v. Taylor*, 122 Wash. 466, 210 P. 806; *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Martinsburg & Potomac Railroad Co. v. March*, 114 U. S. 549, 5 S. Ct. 1035, 29 L. Ed. 255.

<sup>10</sup> *Martinsburg & Potomac Railroad Co. v. March*, 114 U. S. 549, 5 S. Ct. 1035, 29 L. Ed. 255; *New England Trust Co. v. Abbott, Ex'r*, 162 Mass. 148, 38 N. E. 432, 27 L. R. A. 271; *Berger Mfg. Co. v. Huggins*, 242 F. 853; *Citizens' Independent Mill & Elevator Co. v. Perkins*, 52 Okla. 242, 152 P. 443; *Hayes Grain & Commission Co. v. Federal Grain Co.*, 169 Ark. 1072, 277 S. W. 521; *Arkansas Cotton Growers' Coop. Association v. Brown*, 179 Ark. 338, 16 S. W. 2d 177.

certain milk dealers had rejected milk. A member, whose milk had been accepted and paid for by the dealer at the full sale price, objected to bearing any part of the loss on account of the rejected milk. He successfully sued the association and recovered the amount of the loss which the association sought to have him bear.<sup>11</sup>

Of course, if the bylaws or marketing contract of an association provides for a certain method of pooling, this method and no other should be followed.<sup>12</sup> An association's bylaws and marketing agreement provided for daily pools, and it was held that this barred the association from distributing the proceeds of sales to members in any other way, regardless of the fact that the officers of the association apparently were of the opinion that "inequitable" results were thus attained.<sup>13</sup> On the other hand, if an association is not authorized to pool commodities which it is handling, it may be liable if it mixes the commodities received from one member with those received from others.<sup>14</sup>

Under the usual form of pooling contract, if products are burned the insurance proceeds take the place of the products in the pool, and the fact that the identity of the products burned is known is immaterial and does not give the producer of them any rights to the insurance proceeds independent of his rights of participating in the returns of the pool.<sup>15</sup>

Generally, it appears that a member of an association pooling and marketing agricultural commodities is entitled to receive an itemized statement, by pools, showing gross prices received for such products and how the net amount to be paid him by the association was determined.<sup>16</sup>

Milk associations frequently employ equalization pools into which distributors of milk make payments based upon the specific uses made of the milk delivered by the members of an association, for the purpose of equalizing the returns to members.<sup>17</sup>

A marketing contract may be so drawn that, even if the grower is given the option of determining when "his products" shall be sold or the "price fixed" with reference thereto, the association is not required to keep on hand the specific products delivered by the member, but only an equivalent quantity of products of like grade.<sup>18</sup>

Some associations use marketing contracts which give their members various options with respect to the pooling and selling of their commodities.<sup>19</sup> Sometimes a member may be given the option to have his commodities sold separately.

When an association was authorized to pool products and proceeds arising from their sale, the relation existing between the association and

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<sup>11</sup> *Steelman v. Oregon Dairymen's League, Inc.*, 97 Ore. 535, 192 P. 790. See also *Cole v. Southern Michigan Fruit Association*, 260 Mich. 617, 245 N. W. 534.

<sup>12</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419.

<sup>13</sup> *Cole v. Southern Michigan Fruit Association*, 260 Mich. 617, 245 N. W. 534. See also *Steelman v. Oregon Dairymen's League, Inc.*, 97 Ore. 535, 192 P. 790.

<sup>14</sup> *Imperial Valley Long Staple Cotton Growers' Association v. Davidson*, 58 Cal. App. 551, 209 P. 58.

<sup>15</sup> *Texas Certified Cottonseed Breeders' Association v. Aldridge*, 422 Tex. 464, 61 S. W. 2d 79, reversing 59 S. W. 2d 320 (Tex. Civ. App.); *Johnson v. Staple Cotton Coop. Association*, 142 Miss. 312, 107 So. 2.

<sup>16</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190.

<sup>17</sup> *Stark County Milk Producers' Association v. Tabeling*, 129 Ohio St. 159, 194 N. E. 16, 98 A. L. R. 1393; *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, 59 S. Ct. 993, 83 L. Ed. 1446.

<sup>18</sup> *Alabama Farm Bureau Cotton Association v. Dale*, 223 Ala. 164, 134 So. 646.

<sup>19</sup> *Ibid.*, n. 18.

a member following the sale of the products was that of debtor and creditor and the officers were not liable for conversion, although a receiver was appointed for the association before settlement was made.<sup>20</sup>

### Excess Advances or Payments

Cooperatives frequently make advances or partial "payments" to their members on receipt of their products. The question arises, in the event the advances or payments made exceed the amount to which the member is entitled, after deducting marketing expenses and all other authorized deductions from the sales returns, may the association recover the amount of such excess advances or payments from the member? The answer is "Yes," in most instances. The basis for the recovery is the doctrine that no man shall be allowed to enrich himself unjustly at the expense of another or shall be allowed to retain money that in "equity and good conscience" belongs to another.<sup>21</sup>

The simplest case in which this question could arise would probably be that of an association that functioned on a commission or brokerage basis; for example, a cooperative livestock-selling agency. If a shipper to such an agency should draw a draft against it in connection with a shipment of livestock made thereto, and the proceeds from the sale of the livestock, after marketing expense had been deducted, should be less than the amount of the draft, the cooperative agency could then successfully sue the shipper for the difference between the amount of the draft and the net proceeds received for the livestock.

The right of commission merchants and factors to recover the amount of excess advances made by them is settled,<sup>22</sup> and this right is possessed also by cooperatives that function along the same general lines. Whether the cooperative uses the purchase-and-sale or the agency type of contract, the obligation of the association should be to pay the member the amount received for his products on a pool basis or otherwise, less authorized deductions. If a member, regardless of the type of contract involved, receives more than this amount, he has received something to which he is not entitled, and hence the association may recover it. A number of cooperative associations have done so.<sup>23</sup>

In the case just cited involving the California Raisin Growers' Association, the cooperative, which functioned on an agency basis, successfully brought suit against some 600 growers on account of excess advances made to them, for the purpose of having the money distributed among members of the association who had been underpaid and among certain creditors of the association who were also parties to the suit.

The contracts of a cooperative should be so worded as to show clearly the

<sup>20</sup> *Winans v. Brue (Kennewick Richland Marketing Union)*, 140 Wash. 56, 248 P. 62.

<sup>21</sup> *Jackson v. Creek*, 47 Ind. App. 541, 94 N. E. 416.

<sup>22</sup> *Re Estate of Joseph P. Murphy Co.*, 214 Pa. 258, 63 A. 745, 5 L. R. A. (N. S.) 1147; *Newburger-Morris Co. v. Talcott*, 219 N. Y. 505, 114 N. E. 846, 3 A. L. R. 287.

<sup>23</sup> *Arkansas Cotton Growers' Coop. Association v. Brown*, 179 Ark. 338, 16 S. W. 2d 177; *California Raisin Growers' Association v. Abbott*, 160 Cal. 601, 117 P. 767; *Sugar Loaf Orange Growers' Association v. Skewes*, 47 Cal. App. 470, 190 P. 1076; *California Bean Growers' Association v. Williams*, 82 Cal. App. 434, 255 P. 751; *Lake Charles Rice Milling Co. v. Pacific Rice Growers Association*, 295 F. 246. See also *Farmers' Union Coop. Shipping Association of Natoma v. Schultze*, 112 Kan. 675, 212 P. 670; *Davidson v. Apple Growers' Association*, 159 Ore. 473, 79 P. 2d 991; *People v. Mills*, 41 Cal. App. 2d 260, 106 P. 2d 216, 628.



exact method of disbursement. In a Wisconsin case<sup>24</sup> in which the marketing contract provided for advances but also stipulated "that payment shall be made on the 20th day of each month for cheese shipped by the local during the month before the month which precedes the date of payment," the court held that the disbursements which were made to the local association were made as payments and not as advances and, therefore, that the association was not entitled to recover excess advances.

A Minnesota case,<sup>25</sup> although it does not cite the Wisconsin case, is essentially consistent with it in theory. That case held that a trustee in bankruptcy for a cooperative creamery could not recover from members and patrons any part of the price paid for products, even though such price may have exceeded the difference between the association's gross receipts from the marketing of such products and its operating expenses during the respective years by periods, because the contractual relationship between the creamery and its patrons was one of purchaser and seller; not that of principal and agent.

The decision in a New Jersey case<sup>26</sup> that an association doing business on "a cash basis" may recover overpayments for products unless the association's losses were occasioned by some negligence, fault, or misconduct of the association itself in marketing the products is also not considered inconsistent in view of the court's statement that by the terms of its charter and bylaws, "\* \* \* the association, in marketing the produce of the farmer members, was acting as agent of the members, and substantially as a clearinghouse, \* \* \*."

If an association has in fact agreed to pay a minimum price to its members, it has been held that no recovery may be had if the commodities fail to bring the minimum price.<sup>27</sup>

When excess advances or payments are made by an association that functions on a pool basis, there is always the strong possibility that some members have received less than they were entitled to; whereas other members have received more than the amount to which they were entitled. This situation would provide an additional reason for allowing an association to recover excess advances. The principles under discussion are applicable, even in cases in which an association in its contract agrees to make an advance of a specified amount to growers, which amount proves to be excessive, because both parties assume that the products will bring a net amount larger than the advance. If this assumption proves to be incorrect, the necessary adjustments are in order. The association contracts to pay to its members only the net amount received by it for their products, minus authorized deductions. If more is paid, a member has received something to which he has no claim. No reason is apparent why these principles would not be as applicable to an unincorporated as to an incorporated association; and, in a Kentucky case<sup>28</sup> involving an unincorporated association, the members were held liable for overadvances made to them.

Where an association borrowed money on cottonseed and made advances

<sup>24</sup> *Neith Cooperative Dairy Products Association v. National Cheese Producers' Federation*, 217 Wis. 202, 257 N. W. 624, 98 A. L. R. 1403. See also *Yakima Fruit Growers' Association v. Hall*, 180 Wash. 365, 40 P. 2d 123.

<sup>25</sup> *Elliott v. Adeckes*, 240 Minn. 113, 59 N. W. 2d 894.

<sup>26</sup> *Lewis v. Monmouth County Farmers' Cooperative Association*, 105 N. J. Eq. 257, 147 A. 550.

<sup>27</sup> *Yakima Fruit Growers' Association v. Hall*, 180 Wash. 365, 40 P. 2d 123.

<sup>28</sup> *Tomlin v. Petty*, 244 Ky. 542, 51 S. W. 2d 663.

to its members, the court said: "If the seed is not sold, certainly the association could recover the excess advances to any one member."<sup>29</sup>

If an association makes advances to its members with borrowed money and the advances prove to be excessive, resulting in the insolvency of the association unless the excess advances are recovered from the members, the creditors of the association, if it fails or refuses to take action to recover the excess advances, can have the association placed in the hands of a receiver. The receiver can then recover the excess advances from the members, assuming the association could recover, because such excess advances are assets of the association or obligations due it.

Where a mortgagee of rice, with knowledge of the marketing contract entered into by his mortgagor with a cooperative, availed himself of the services of the association, the trustee in bankruptcy of the association was entitled to recover overadvances made to the mortgagee.<sup>30</sup>

In a New York case<sup>31</sup> a cooperative entered into a contract with a commercial firm for the sale by that firm on commission of all the wool which the members of the association consigned or delivered to the association for sale. In pursuance of this contract, the firm advanced money to the association which was advanced by the association on wool as it was received and graded. The wool sold for less than the advances thereon. In a suit to recover such overadvances, it was held that the four members of this incorporated association who had been served with process were not jointly or severally liable for all the overadvances. On the other hand, in a case<sup>32</sup> involving an unincorporated association in which the facts were substantially the same it was held that the president and all its members were liable jointly for overadvances.

Where an association made overadvances to a tenant who with his landlord had signed a marketing agreement with the association, it was held that the landlord was liable for such overadvances as the court regarded the landlord, under the facts in question, as a guarantor.<sup>33</sup>

Overadvances have caused the failure of some associations. Even if an association has the legal right to recover overadvances, practical considerations frequently make it undesirable to do so. Lawsuits do not encourage patronage; on the contrary, they encourage withdrawals. In some instances, the indebtedness due an association by a member because of an overadvance is deducted from the proceeds received by the association from products delivered by him in subsequent years. Likewise, associations may offset overadvances against patronage refunds. However, the safest course for an association to follow is to avoid making overadvances.

### Effect of Breach of Contract

What is the real character of the form of cooperative marketing contract commonly entered into by cooperatives with their members? Do such contracts constitute contracts between and among the members as well as with

<sup>29</sup> *Texas Certified Cottonseed Breeders' Association v. Aldridge*, 122 Tex. 464, 61 S. W. 2d 79, 84, reversing 59 S. W. 2d 320 (Tex. Civ. App.).

<sup>30</sup> *Baird v. Gleason*, 53 F. 2d 785.

<sup>31</sup> *Mandell v. Cole*, 244 N. Y. 221, 155 N. E. 106. See also *Barnett Bros. v. Lynn*, 118 Wash. 308, 203 P. 387; *Sullivan v. American Fruit Growers, Inc.*, 45 Idaho 153, 260 P. 1029.

<sup>32</sup> *Mandell v. Moses*, 209 App. Div. 531, 205 N. Y. S. 254, affirmed in 239 N. Y. 555, 147 N. E. 192.

<sup>33</sup> *McDonald v. Gravenstein Apple Growers Coop. Association*, 42 Cal. App. 2d 329, 108 P. 2d 936.

the association? Is a member relieved from the obligation to deliver his products to the association for marketing because the association has committed a breach of the marketing contract or has failed to abide by its bylaws?

The general rule is that "the party to a contract who commits the first breach is the wrongdoer and thereby absolves the other party from performance." But is this rule fully applicable to cooperative associations in differences with their members? Strong reasons exist for urging that the rule has less application to such contracts than to the ordinary business contract. Cooperative contracts are apparently universally regarded as not only contracts with cooperatives as legal entities, but as contracts between and among the various members.<sup>34</sup> An advantage given one member is ordinarily at the expense of other members. The defection of a member may increase the share of the total expenses that each of the others is called upon to pay.

The effectiveness and efficiency of an association depend to a high degree on the faithfulness with which each member works with all the other members.

They [marketing contracts] are not simply agreements entered into with an agent, although a few people may be selected to act in the capacity of officers to manage the business of the association. The agreements are essentially to and with all the other members of the cooperative association, and the interests of every member rest upon the same foundation, and no member can be advantaged to the detriment of any other member.<sup>35</sup>

To release a member from his contract or to permit him to defend a suit brought against him by the association by showing that directors or an officer, manager, or some other employee of the association has done something which should not have been done, or has failed to do something which should have been done, fails to take into consideration the obligation of the member in question to all the other members. Clearly, the contract among the members is not breached by the act of omission or commission, as the case may be, on the part of a delinquent officer or manager of the association.

The proposition becomes more transparent if the same situation arises with respect to an unincorporated association in which various producers are banded together by a contract which specifies that a certain party, or parties, is to act as marketing agent, and which vests in this agent certain stated powers. If the agent is delinquent or fails to abide by the terms of the contract, this would not release a producer from the contract or enable him to excuse nonperformance of his obligations under the contract. It would be obvious that the remedy lay in discharging the agent or in taking other appropriate action within the association for correcting the situation.

Does the fact that an association is incorporated change the essential character of the enterprise? The interdependent relation among the members is present in each case. The object sought to be accomplished is the same. The means employed are identical except for incorporation. At

<sup>34</sup> *McCauley v. Arkansas Rice Growers' Coop. Association* 171 Ark. 1155, 287 S. W. 419; *Staple Cotton Coop. Association v. Borodofsky*, 143 Miss. 558, 108 So. 802; *Haarparinne v. Butter Hill Fruit Growers' Association*, 122 Me. 138, 119 A. 116; *Manchester Dairy System, Inc. v. Hayward*, 82 N. H. 193, 132 A. 12; *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *California Canning Peach Growers v. Downey*, 76 Cal. App. 1, 243 P. 679; *Anaheim Citrus Fruit Association v. Yeoman*, 51 Cal. App. 759, 197 P. 959; *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311.

<sup>35</sup> *California Canning Peach Growers v. Downey*, 76 Cal. App. 1, 243 P. 679, 684.



least one appellate court has given partial if not complete application to the doctrine under discussion, and in this connection said: "Appellants signed the 'marketing contract' with the other members of the association. Hence, appellants' agreements were made in consideration of like agreements of the other members and for their mutual advantage. If appellants could be absolved from the performance of the contract because the officers of the association had committed breaches of the contract in certain respects, it is certain that the other members of the association would suffer by this course."<sup>36</sup>

In this case the court held that 118 members of the association, who had joined in a suit for the purpose of having the association placed in the hands of a receiver, would be required to carry out their marketing contracts in the future, but also held that the association should be enjoined from seeking to collect liquidated damages from the members on account of their failure to abide by their contracts in the past. As to the future, the court held that the members must specifically perform their contracts.

On the other hand, as will be shown in the following section, the failure of a cooperative to carry out the terms of its marketing contract with a member has frequently been held to constitute a defense to a suit brought by the association against the member on the contract.

As a general rule, it is believed that when members of an association believe that the directors they have elected to manage the association, or its officers or other agents, are not complying with its charter, bylaws, or marketing contract, they should be required to seek relief within the association through the election of new directors and officers, or the enjoining of them, or through other corrective measures.<sup>37</sup> To use a figure of speech, the members of a cooperative embark together for a common voyage and no member should be allowed to leave the ship except in accordance with specified conditions.

## Defenses to Contracts

A member of a cooperative may not question the constitutionality of the statute under which the association is incorporated, or the terms of the contract entered into with the association.<sup>38</sup> Likewise, members are generally held to be estopped from setting up the invalidity of certificates of stock.<sup>39</sup>

Although the charter of a corporation did not disclose that it was intended to function on a cooperative basis, a stockholder who became such with knowledge of the fact that the corporation was so functioning could not successfully complain of this fact.<sup>40</sup>

Before an association was incorporated, a producer signed a contract providing for the delivery of milk by him. It was found that the associa-

<sup>36</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419, 423.

<sup>37</sup> Cf. *Indianapolis Dairymen's Cooperative, Inc. v. Bottema*, 226 Ind. 237, 79 N. E. 2d 399; 226 Ind. 260, 79 N. E. 2d 409.

<sup>38</sup> *Johnson v. Georgia-Carolina Retail Milk Producers Association*, 182 Ga. 695, 186 S. E. 824; *Owen County Burley Tobacco Society v. Brumback*, 128 Ky. 137, 149, 107 S. W. 710. See also *Lennox v. Texas Cotton Coop. Association*, 55 S. W. 2d 543 (Tex. Com. App.); *Zander v. Schackel*, 161 Minn. 116, 201 N. W. 308; *Hancock v. Frederick Coop. Mercantile Co.*, 48 S. D. 1, 201 N. W. 714; *Berry v. Maywood Mutual Water Company Number 1*, 13 Cal. 2d 185, 88 P. 2d 705; *Vermont Farm Machinery Co. v. DeSota Cooperative Creamery Co.*, 145 Iowa 491, 122 N. W. 930.

<sup>39</sup> *Bliss v. California Coop. Producers*, 23 Cal. App. 2d 245, 72 P. 2d 885.

<sup>40</sup> *Allen v. Llano Del Rio Co. of Nevada*, 166 La. 77, 116 So. 675.

tion was authorized to do business with members only and as neither the producer nor the association had complied with the bylaw provisions for making the producer a member, the association could not enforce its contract with the producer.<sup>41</sup>

Mismanagement or unwise conduct of the affairs of an association is no defense to a suit for breach of a marketing contract.<sup>42</sup> The courts analogize the marketing contracts of an association for the delivery of products to contracts of commercial corporations for the delivery of money thereto in payment for stock purchased, and the rule is that mismanagement of a commercial corporation is no defense to a suit for the recovery of the purchase price of stock.<sup>43</sup>

It has been held that the alleged failure of the association correctly to account operated to relieve a member from his obligations under the contract.<sup>44</sup> Again it has been held that the release by the directors of certain members operated to release other members from performing their contracts.<sup>45</sup> It has been intimated that the failure on the part of an association to enforce its marketing contract against certain members might operate to release others.<sup>46</sup>

In a Washington case<sup>47</sup> in which it was contended "that no member of the association could lawfully be released from his membership contract and obligations without the consent of all the members of plaintiff association" it was held that compromise agreements entered into by the officers of an association with members, which released the members from their obligations to deliver their commodities under the marketing contracts, were valid. It appeared that with respect to all but one of these members there was a question regarding the validity of the contracts; that all the members paid money to the association for the purpose of obtaining release from their marketing contracts; and that, after the compromise agreements were consummated, all the members of the association had knowledge thereof and made no objection thereto.

Although an association may be justified in breaching its marketing contract by refusing to receive commodities, it has been held that the refusal of an association to allow the grower to sell such commodities to others permits the member to recover his membership fee.<sup>48</sup>

<sup>41</sup> *Tulsa Milk Producers' Cooperative Association v. Hart*, 145 Okla. 263, 292 P. 558.

<sup>42</sup> *Nebraska Wheat Growers' Association v. Smith*, 115 Neb. 177, 212 N. W. 39; *Pittman v. Tobacco Growers' Coop. Association*, 187 N. C. 340, 121 S. E. 634. See also *California Bean Growers' Association v. Rindge Land & Nav. Co.*, 199 Cal. 168, 248 P. 658, 47 A. L. R. 904; *Toy v. Lapeer Farmers Mutual Fire Insurance Association*, 297 Mich. 174, 297 N. W. 232; *California Bean Growers' Association v. Sanders*, 86 Cal. App. 689, 261 P. 717.

<sup>43</sup> *Mississippi, Ouachita & Red River R. R. Co. v. Cross*, 20 Ark. 443; 7 R. C. L. sec. 235; 4 FLETCHER CYCLOPEDIA CORPORATIONS, Perm. Ed., secs. 1777-1778; *American Building & Loan Association v. Rainbolt*, 48 Neb. 434, 67 N. W. 493. See also *Brewer v. Boston Theater Co.*, 104 Mass. 378.

<sup>44</sup> *Brown v. Georgia Cotton Growers' Coop. Association*, 164 Ga. 712, 139 S. E. 417; *New Jersey Poultry Producers' Association v. Tradelius*, 96 N. J. Eq. 683, 126 A. 538.

<sup>45</sup> *Staple Cotton Coop. Association v. Borodofsky*, 143 Miss. 558, 108 So. 802. See also *Beaulaurier v. Washington State Hop Producers, Inc.*, 8 Wash. 2d 79, 111 P. 2d 559.

<sup>46</sup> *California Bean Growers' Association v. Rindge Land & Nav. Co.*, 199 Cal. 168, 248 P. 658, 47 A. L. R. 904.

<sup>47</sup> *Washington State Hop Producers v. Eglin*, 6 Wash. 2d 531, 108 P. 2d 329, 330. See also *Beaulaurier v. Washington State Hop Producers, Inc.*, 8 Wash. 2d 79, 111 P. 2d 559.

<sup>48</sup> *Central Texas Dairymen's Association v. Jones*, 67 S. W. 2d 896 (Tex. Civ. App.). See also *Kansas Wheat Growers' Association v. Toothaker*, 128 Kan. 469, 278 P. 716.

In an Oregon case<sup>49</sup> in which the court found that, "The price did not depend on what any other grower was to get, and the release of another grower could not in any way increase or diminish his compensation," it was held that the release of a member from his contract did not release others.

If an association by the terms of its marketing contract is required to receive the products covered thereby, refusal to accept such products terminates the marketing contract.<sup>50</sup>

A cotton cooperative entered into an agreement to purchase cotton of a given grade and staple and at certain prices. It received the cotton and paid therefor "as the cotton was shipped to it upon the basis that it was all according to the classification set forth in the agreement." The association rejected 1,596 bales of cotton and then filed a suit "to recover on an account stated and to recover for storage charges and insurance on rejected cotton."

Although there appears to have been a substantial dispute in the testimony, the trial court held that the cotton had been arbitrarily rejected and that, therefore, the association was not entitled to recover. This judgment was affirmed by the appellate court. On appeal, it was held that because of the finding that the cotton had been arbitrarily rejected for not being of proper grade, the relationship of debtor and creditor did not arise and hence the association could not maintain an action for an account stated, or for storage charges and insurance in connection with such cotton.<sup>51</sup>

The unjustified refusal of an association to regrade a grower's tobacco was held to justify a grower's refusal to continue performance under his marketing agreement.<sup>52</sup> Again, when a milk association required a member to install expensive equipment which it was apparently not authorized to require by the terms of the marketing contract, the court was of the opinion that this would constitute a defense to a suit against the producer on his contract.<sup>53</sup> In a California case a producer was permitted to show, when sued on a written contract, that an oral agreement had been substituted therefor.<sup>54</sup> But statements and actions by an association which are consistent with its marketing agreement have no adverse effect thereon.<sup>55</sup>

When a member of an association does not object to a practice which the association is following, but apparently acquiesces therein, he may be estopped from questioning the practice.<sup>56</sup>

In a New York case, a member of a cooperative contended that the asso-

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<sup>49</sup> *Phex Co. v. Salem Fruit Union*, 103 Ore. 514, 201 P. 222, 232, 205 P. 970, 25 A. L. R. 1090.

<sup>50</sup> *Central Texas Dairymen's Association v. Jones*, 67 S. W. 2d 896 (Tex. Civ. App.). See also *Guglielmelli v. Walla Walla Gardners' Association*, 157 Wash. 109, 288 P. 251, 77 A. L. R. 385; *Mountain States Beet Growers' Marketing Association v. Monroe*, 84 Colo. 300, 269 P. 886; *Wisconsin Cooperative Milk Pool v. Saylesville Cheese Manufacturing Company*, 219 Wis. 350, 263 N. W. 197.

<sup>51</sup> *California Cotton Coop. Association v. Byrne*, 58 Cal. App. 2d 84, 136 P. 2d 359.

<sup>52</sup> *Myrold v. Northern Wisconsin Cooperative Tobacco Pool*, 206 Wis. 244, 239 N. W. 422.

<sup>53</sup> *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391.

<sup>54</sup> *Producers' Fruit Company of California v. Goddard*, 75 Cal. App. 737, 243 P. 686. Cf. *Matanuska Valley Farmers Cooperative Association v. Monaghan*, 188 F. 2d 906.

<sup>55</sup> *Meyer v. California Prune & Apricot Growers' Association*, 42 Cal. App. 2d 632, 109 P. 2d 726.

<sup>56</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190.



ciation had breached its contract with him, but inasmuch as the member continued to make deliveries of milk for a month thereafter, it was held that any alleged previous irregularities did not justify the member in refusing to deliver milk under his contract.<sup>57</sup>

In an Oregon case<sup>58</sup> it was said—

the rendition of statements each fiscal year to plaintiff and “the purchasers” and plaintiff’s failure to object to or protest against such statements of account within a reasonable time thereafter constitute an account stated as to the transactions therein involved.

If a member of an association breaches his marketing contract during a given season, he cannot successfully defend a suit brought by the association on account of such breaches by showing that subsequent thereto the association breached the contract.<sup>59</sup> The assertion by a producer that he received less for his products through the association than he would have received by selling to others is no defense to a suit for breach of the contract.<sup>60</sup>

Under the laws of many States corporations are required to file reports. It is sometimes provided by statute that failure to file a report on or before a given date makes invalid contracts entered into while the corporation is in default.<sup>61</sup>

## Deductions

WHAT deductions may an association make from the returns received for the products of its members? The answer is, Only those deductions authorized under the contract or bylaws of the association.<sup>62</sup> The fact that deductions, in addition to those specifically authorized, appear necessary or highly advisable does not justify such deductions.

In considering the matter of deductions, a sharp distinction should be drawn between amounts in the hands of an association, arising from the sale of commodities delivered by its members and for which it may be said that the association is indebted<sup>63</sup> to the members, and amounts which the association is authorized to retain out of such sale proceeds.

Money deducted from the returns from the sale of members’ products may be used by the association only for the specific purposes for which deducted. In other words, if the marketing contract or a bylaw of an

<sup>57</sup> *Parker v. Dairymen’s League Cooperative Association, Inc.*, 226 N. Y. S. 226, 222 App. Div. 341. See also *Lennox v. Texas Farm Bureau Cotton Association*, 16 S. W. 2d 413 (Tex. Civ. App.); *California Prune & Apricot Growers, Inc., v. Baker*, 77 Cal. App. 393, 246 P. 1081; *Beaulaurier v. Washington State Hop Producers, Inc.*, 8 Wash. 2d 79, 111 P. 2d 559.

<sup>58</sup> *Davidson v. Apple Growers’ Association*, 159 Ore. 473, 79 P. 2d 991, 998. See also *Boyle v. Pasco Growers’ Association, Inc.*, 170 Wash. 516, 17 P. 2d 6.

<sup>59</sup> *Nebraska Wheat Growers’ Association v. Smith*, 115 Neb. 177, 212 N. W. 39; *California Bean Growers’ Association v. Rindge Land & Nav. Co.*, 199 Cal. 168, 248 P. 658, 47 A. L. R. 904; *California Prune & Apricot Growers, Inc. v. Baker*, 77 Cal. App. 393, 246 P. 1081.

<sup>60</sup> *Nebraska Wheat Growers’ Association v. Smith*, 115 Neb. 177, 212 N. W. 39; *Arkansas Cotton Growers’ Coop. Association v. Brown*, 179 Ark 338, 16 S. W. 2d 177.

<sup>61</sup> *Detroit United Fruit Auction Company v. Kroger Grocery & Baking Company*, 227 Mich. 412, 198 N. W. 947.

<sup>62</sup> *Silveira v. Associated Milk Producers*, 63 Cal. App. 572, 219 P. 461; *Fietz v. Central Milk Producers Coop. Association, Inc.*, 32 N. Y. S. 2d 574. See also *Davidson v. Apple Growers’ Association*, 159 Ore. 473, 79 P. 2d 991.

<sup>63</sup> *Hood River Orchard Co. v. Stone*, 97 Ore. 158, 191 P. 662; *Ozona Citrus Growers’ Association v. McLean*, 122 Fla. 188, 165 So. 625; *Bogardus v. Santa Ana Walnut Growers’ Association*, 41 Cal. App. 2d 939, 108 P. 2d 52; *Buford v. Florin Fruit Growers’ Association*, 210 Cal. 84, 291 P. 170; *Loomis Fruit Growers’ Association v. California Fruit Exchange*, 128 Cal. App. 265, 16 P. 2d 1040.

association specifies that deductions shall be made for certain itemized purposes, the deductions made can lawfully be employed for no other purposes.

Membership fees, dues, or money received from the sale of stock, or any other money (unless received with the understanding that it is to be used for a specific object), may be used for any purpose or object covered by the charter of the association; and, if the charter is sufficiently broad, such money may be used (as was done in a California case,<sup>64</sup> for instance) for advocating a higher tariff on the products handled by the association.

Unless expressly authorized to do so, an association may not use money derived from the sale of the crop of one season, to which its growers are entitled, for financing the handling of the crop of a succeeding season.<sup>64</sup> Under marketing contracts of the usual type the courts regard each year as a unit, so that those who were members during a given year are entitled to the money arising from that year's operations after subtracting expenses and other authorized deductions even though, it has been held, a part of the money received consisted of commissions paid by nonmembers of the association for selling their products, although the association was not authorized to handle nonmember business.<sup>65</sup>

An association may, in good faith, when its contract provides therefor, pay off a mortgage on a member's crop so as to permit the marketing of the crop through the association.<sup>66</sup> If a loss arises from paying off such a mortgage, it is chargeable against and should be borne by the member in question;<sup>67</sup> and the fact that an association suffers a loss by paying off a mortgage on a member's crop, if the payment was made in good faith, does not relieve other members from their contracts.<sup>68</sup>

If the bylaws or marketing agreement authorizes deductions for permanent reserves, that is for money that may be retained and used by the association in the year or years following that in which deducted, such a provision is valid.<sup>69</sup> The question arises, Is an association required to account to a member for deductions made for permanent reserves other than by showing the amount of them? If the deductions were made pursuant to provisions that showed that the member was merely making a loan to the association which was to be paid on the dissolution of the association or on some future date or occasion, then obviously the member becomes a creditor of the association subject to the terms of the loan, and such is the case when certificates of indebtedness are employed.

If, on the other hand, there is nothing to show that the deductions for reserves are loans, then the member has no legal claim of any character upon the association in the absence of a stipulation providing therefor. Under such circumstances neither stockholder nor member could success-

<sup>64</sup> *California Bean Growers' Association v. Rindge Land & Nav. Co.*, 199 Cal. 168, 248 P. 658, 47 A. L. R. 904.

<sup>65</sup> *McCauley v. Arkansas Rice Growers Coop. Association*, 171 Ark. 1155, 287 S. W. 419.

<sup>66</sup> *Cunningham v. Long (Maine Potato Growers Exchange)*, 125 Me. 494, 135 A. 198.

<sup>67</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419.

<sup>68</sup> *Cunningham v. Long (Maine Potato Growers Exchange)*, 125 Me. 494, 135 A. 198.

<sup>69</sup> *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Burley Tobacco Growers' Coop. Association v. Tipton*, 227 Ky. 297, 11 S. W. 2d 119; *Burley Tobacco Growers' Coop. Association v. Brown*, 229 Ky. 696, 17 S. W. 2d 1002.

fully sue an association to recover the amount of deductions for reserves made from the proceeds received for his products.<sup>70</sup>

In one case<sup>71</sup> the question involved was whether a tobacco cooperative had the right to retain certain net margins realized from the sale of members' tobacco as revolving capital reserves. The tobacco in question had been pledged as security for price support loans, the association, acting as agent for Commodity Credit Corporation to administer the program. The tobacco, having failed to bring the support price, was held by the association after payment to the grower of the support price. It was later sold by the association for more than the loans for which it was pledged, thus creating an equity for the growers. The association's agreement with Commodity Credit Corporation required these excess amounts to be "distributed" to the growers. The association's marketing contract provided for retaining reasonable reserves, so it contended that it had "distributed" the amounts when it allocated the "reserves" to the growers. The plaintiffs contended that the "distribution" had to be by payment in cash.

The lower court avoided a construction of the contracts involved and held, in effect, that the patrons should be given the option of having the net proceeds either paid to them in cash or invested in the capital of the association.

On appeal, the Court said that the right of the association to use equities as revolving capital "must be resolved in the light of the intent of the Congress in creating Commodity Credit Corporation and providing it with funds to support the price of certain selected commodities, including tobacco." It said further:

Any right of the association to infringe upon the rights of growers must derive either from the Federal Government which made possible the realization of a profit or from the grower whose crop the association has sold. In our opinion it has not been able to trace its claim to either source. We think any grower reading the contract in advance of the sale of his crop would have concluded that "distribution" meant distribution in cash upon the liquidation of the crop for the year rather than allocation according to cooperative usage and custom upon the books of the association. As to such grower's crop under its contract with Commodity Credit Corporation, the association was to act as an agent of the Federal Government and not in its capacity as a cooperative benefiting the industry as a whole.

The Court held that under that contract the association could not use the equities for capital unless authorized by Commodity Credit Corporation to do so. It found that such consent had not been obtained.

The provisions in marketing agreements and bylaws with respect to deductions, especially deductions for reserves, and with respect to what action the board of directors may take in the event of losses should be clear and explicit and should leave no doubt as to the rights of the association with respect thereto.<sup>72</sup> Broadly speaking, deductions for reserves are deductions for capital and should be clearly recognized as such.

Sometimes a question arises between an association and a member as to whether the association was authorized to make certain deductions. In general, in a case of this character, if the association has rendered a statement of account to the member showing the deductions and he does not

<sup>70</sup> *Burley Tobacco Growers' Coop. Association v. Brown*, 229 Ky. 696, 17 S. W. 2d 1002.

<sup>71</sup> *Range v. Tennessee Burley Tobacco Growers Association*, — Tenn. —, 298 S. W. 2d 545.

<sup>72</sup> *Burley Tobacco Growers' Coop. Association v. Tipton*, 227 Ky. 297, 11 S. W. 2d 119; *Burley Tobacco Growers' Coop. Association v. Brown*, 229 Ky. 696, 17 S. W. 2d 1002; *Ozona Citrus Growers' Association v. McLean*, 122 Fla. 188, 165 So. 625.



object to the statement within a reasonable period of time, this is held to constitute an "account stated" and the member loses his right to question such deductions.<sup>73</sup> However, if objections are registered within a reasonable time the right to question the deductions is preserved.<sup>74</sup>

It has been held that when an association adopts a bylaw that affects existing and future financial rights of members, a member may be bound thereby although he did not vote in favor thereof, if he did not object to deductions made in accordance with the bylaws but apparently acquiesced therein.<sup>75</sup>

Many of the cooperative statutes provide for appraisal of the interest of a member of a nonstock association on the termination of his membership and for payment to him, on stated terms, of the amount thus ascertained. But this does not mean that a withdrawing member would be entitled to receive the amount deducted for reserves for the proceeds derived from the sale of his products. Appraisal of the interest of a member of a nonstock association on the termination of his membership, when the statutes provide for this procedure, is equivalent to the price received by a stockholder in a stock association on the transfer of his stock.

On the dissolution of an association, at common law, whether stock or nonstock, the money remaining in the treasury after payment of the debts of the association goes to the persons who are at that time stockholders or members.<sup>76</sup> Those who had previously contributed to the organization, but were not stockholders or members at the time of dissolution, would be entitled to nothing. This rule is applicable to all associations except as it has been modified by statute, charter, bylaws,<sup>77</sup> or contract.

Reserves of an association may be used for the payment of its debts and until the debts of an association have been paid<sup>78</sup> the reserves cannot be distributed among its members or stockholders.

## Assessments

ONE of the means by which the cooperative aim of serving members on a cost basis may be achieved is by the levying of assessments on the members and patrons, for services rendered or to make good deficits in operations. The assessment method is particularly adapted to cooperative service organizations, such as telephone, electric, insurance and irrigation associations. Thus, many farmers' mutual insurance companies are maintained by assessing the members at the end of each year for their

<sup>73</sup> *California Bean Growers' Association v. Williams*, 82 Cal. App. 434, 255 P. 751; *California Bean Growers' Association v. Rindge Land & Nav. Co.*, 199 Cal. 168, 248 P. 658, 47 A. L. R. 904; *Davidson v. Apple Growers' Association*, 159 Ore. 473, 79 P. 2d 991; *Mountain View Walnut Growers Association v. California Walnut Growers Association*, 19 Cal. App. 2d 227, 65 P. 2d 80. See also *May & Ellis Company v. Farmers' Union Mercantile Company*, 120 Ark. 316, 179 S. W. 490; *Huxtable v. Berg*, 98 Wash. 616, 168 P. 187.

<sup>74</sup> *Dryden Local Growers v. Dormaier*, 163 Wash. 648, 2 P. 2d 274. See also *Three Rivers Growers' Association v. Pacific Fruit and Produce Company*, 159 Wash. 572, 294 P. 233.

<sup>75</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190.

<sup>76</sup> *Clearwater Citrus Growers' Association v. Andrews*, 81 Fla. 299, 87 So. 903; *Union Benev. Soc. No. 8 v. Martin*, 113 Ky. 25, 67 S. W. 38; *Dade Coal Co. v. Penitentiary Co.*, 119 Ga. 824, 47 S. E. 338; *Henry v. Cox*, 25 Ohio App. 487, 159 N. E. 101; *Missouri Bottlers' Association v. Fennerty*, 81 Mo. App. 525; 5 C. J. 1360.

<sup>77</sup> *Adams v. Sanford Growers' Credit Corporation*, 135 Fla. 513, 186, So. 239.

<sup>78</sup> *Texas Farm Bureau Cotton Association v. Lennox*, 117 Tex. 94, 297 S. W. 743; *Associated Fruit Co. v. Idaho-Oregon Fruit Growers' Association*, 44 Idaho 200, 256 P. 99; *Van Dyke v. Mid-South Cotton Growers' Association*, 12 F. Supp. 138.

pro rata shares of the losses sustained and the expenses incurred. Similarly, an irrigation company may assess its members at the end of the year for the expense of supplying water during that year. The assessment method is not used by service organizations exclusively. Marketing and farm supply associations sometimes have occasion to levy assessments to meet particular needs and many of the agricultural cooperative acts specifically authorize assessments.

When the statute under which an association is incorporated authorizes an association to adopt bylaws providing for assessments, the right of the association to make them is clear, and reasonable bylaws adopted by the association in pursuance of such authority are binding on the members.<sup>79</sup>

Bylaws providing for assessments have been held valid although, apparently, there was no specific statutory authority therefor.<sup>80</sup>

When the statute under which an association was incorporated conferred the power to levy assessments and a bylaw adopted under the statute vested authority in the board of directors to do so, a member was held liable for an assessment of \$500, even though the charter, in apparent pursuance of the statute, limited the liability of each member to \$1.<sup>81</sup>

It is clear that when neither the statute nor the articles of incorporation, nor the bylaws authorize a majority of the stockholders to obligate all the stockholders to pay additional amounts, or to give notes therefor, additional liability may not be imposed on stockholders who do not authorize or consent thereto.<sup>82</sup>

Stockholders may be liable for assessments even though there is no statutory warrant or authority therefor, by assenting to an agreement to be liable for assessment through purchasing stock evidenced by certificates which on their face refer to such an obligation.<sup>83</sup>

When the statute under which a nonstock association was incorporated did not confer authority to make assessments, it was held that provisions in the articles of incorporation and bylaws, providing for assessments, would not be upheld on the basis of a contract because "the exactions will result in unjust discrimination between its members."<sup>84</sup>

Even though the authority to levy an assessment exists, it may not be levied for carrying out a purpose beyond the powers of the corporation.<sup>85</sup>

Where an association has the statutory power to levy assessments to pay losses and "necessary expenses," it had the power to levy an assessment to pay a claim arising in tort.<sup>86</sup>

<sup>79</sup> *Connecticut Milk Producers' Association v. Brock-Hall Dairy Co., Inc.*, 122 Conn. 482, 191 A. 326; *Ex parte Baldwin County Producers' Corporation*, 203 Ala. 345, 83 So. 69. See also *Lewis v. Monmouth County Farmers' Cooperative Association*, 105 N. J. Eq. 257, 147 A. 550.

<sup>80</sup> *Pennsylvania Milk Producers' Association v. The First National Bank of Honeybrook*, 20 Pennsylvania County Court Reports 540.

<sup>81</sup> *Lockport Cooperative Dairy Association v. Buchner*, 221 N. Y. S. 433, 129 Misc. Rep. 73, affirmed in 217 App. Div. 784, 216 N. Y. S. 865, affirmed in 244 N. Y. 585, 155 N. E. 907. See also *Lewis v. Monmouth County Farmers' Cooperative Association*, 105 N. J. Eq. 257, 147 A. 550.

<sup>82</sup> *Farmers' Coop. Union v. Alderman*, 126 Kan. 299, 267 P. 1110.

<sup>83</sup> *Simons v. Groesbeck*, 268 Mich. 495, 256 N. W. 496.

<sup>84</sup> *Alfalfa Growers of California v. Icardo*, 82 Cal. App. 641, 256 P. 287.

<sup>85</sup> *Seeley v. Huntington Canal & Agricultural Association*, 27 Utah 179, 75 P. 367; *Ehlers v. Farmers Mutual Insurance Company of Thayer County*, 130 Neb. 368, 264 N. W. 894.

<sup>86</sup> *Mortimer v. Farmers' Mutual Fire & Lightning Insurance Association*, 217 Iowa 1246, 249 N. W. 405. But see *Arkansas Valley Cooperative Rural Electric Company v. Elkins*, 200 Ark. 883, 141 S. W. 2d 538, in which the association was held not responsible for a claim arising in tort.

## Assets and Creditors

THE rules which are applicable to business concerns generally, in determining their assets and their liabilities, are applicable to cooperatives. Ordinarily, property to which a concern has legal title is one of its assets.<sup>87</sup>

The question as to what constitutes assets of a cooperative arises most acutely when the rights of creditors are involved. Goods received by a factor, commission man or other agent to sell and then account to the consignor therefor are not liable for the personal obligations of the agent.<sup>88</sup> Likewise, a factor or other agent has no authority at common law to pledge goods received by him to be sold and, without authority from the owner, such goods could not be pledged for an amount in excess of advances made and expenses incurred by the agent on account of such goods.<sup>89</sup> These fundamental principles are fully applicable to cooperatives that operate on an agency basis.<sup>90</sup>

If an association is so operating, the members may, in their marketing agreements, confer on the association authority to borrow on the commodities owned and delivered by them. This is purely a matter of contract. If such authority has been conferred on an association and it has obtained loans on the commodities, the lender, if the requisite formalities have been met, has a good lien on the commodities. It is assumed, of course, that there are no prior and superior liens. As indicated a cooperative may not give a lien on goods which it does not own, or with respect to which it is not authorized to give a lien, to an extent beyond its financial interest therein. On the other hand, the fact that an association operating on an agency basis has the power to borrow on such commodities does not mean that the commodities are assets of the association from the standpoint of an attaching creditor who has not made a loan on them.<sup>91</sup>

If no loans have been obtained on commodities being handled on an agency basis and the members have not agreed that the commodities shall be liable for the debts of the association, they may not be held therefor. Obviously when an association has only authority to borrow on commodities and does not have title thereto, the commodities are not assets of the association from the standpoint of attaching creditors. Normally an association has a lien on commodities received from a member for all advances made to him and for the amount of its "charges." But when an association makes an agreement that it will pay certain notes held by a third person out of the proceeds received from a member's commodities, the rights of the association are junior thereto.<sup>92</sup>

If an association takes title to commodities which it is handling it is believed that such commodities are liable to seizure for debts of the association;<sup>93</sup> and this conclusion would seem to be demanded where the statute under which an association is incorporated specifically provides that if an association enters into a contract of sale with producers "it shall be conclusively held that title to the products passes absolutely and unreservedly,

<sup>87</sup> See Revolving-Fund Plan of Financing, p. 223.

<sup>88</sup> 23 C. J. 352.

<sup>89</sup> *Allen v. St. Louis Bank*, 120 U. S. 20, 7 S. Ct. 460, 30 L. Ed. 573.

<sup>90</sup> *Imperial Valley Long Staple Cotton Growers' Association v. Davidson*, 58 Cal. App. 551, 209 P. 58.

<sup>91</sup> *Runciman v. Brown*, 223 Mich. 298, 193 N. W. 880; *Taylor v. Rugenstein*, 245 Mich. 152, 222 N. W. 107; *Gobles Cooperative Association v. Albright*, 248 Mich. 68, 226 N. W. 876.

<sup>92</sup> *Robinson v. Harry*, 7 Cal. App. 2d 312, 46 P. 2d 806.

<sup>93</sup> See *When Title to Products Passes to Association*, p. 105.



except for recorded liens, to the association upon delivery,"<sup>94</sup> which provision appears in several of the cooperative marketing acts.

Of course, deductions which an association is authorized to make from sales proceeds are ordinarily assets of the association and likewise any net margins realized by an association are assets subject to the claims of its creditors, although the members are the ultimate beneficiaries.<sup>95</sup>

In an Idaho case<sup>96</sup> the court said:

Conceding that profits earned by cooperative nonprofit associations belong to the members, and not to the association itself, we understand the rule to be that such profits are subject to the claims of such associations' creditors, and that, not until such claims are liquidated, may there be a distribution of profits to members. In fact, there can be no profits to distribute until debts are discharged or funds set aside to satisfy them. This is the rule of corporations generally.

In a Texas case<sup>97</sup> referring to a reserve fund accumulated by deductions from sales proceeds, the court said:

It is a corporate fund, a trust fund, and cannot be dissipated until the debts of the corporation have been paid.

Illustrating the fact that when a cooperative is acting as agent only in the sale of commodities received from its members such commodities are not liable for the debts of the association, a Wisconsin case<sup>98</sup> is of interest. In this case, the association was engaged in the sale, on commission, of cheese manufactured from milk belonging to its members. Money derived from the sale of such cheese was deposited by the association in a bank in its own name and the funds were then garnished on account of a debt owed by the association. The court held that these funds could be subjected to the payment of a debt of the association, only to the restricted extent of the compensation to which the association was entitled for the sale of the cheese. The court pointed out that subject to the right of the association to deduct its compensation, the money was held by the association in a fiduciary capacity, and that the character of the fund was not changed by depositing the money in the personal account of the association.

No reason is apparent why the principle followed in the Wisconsin case would not be applicable in any instance in which an association is operating on an agency basis. The fact that the "compensation" of an association is obtained under the name of commissions instead of under the name of deductions is unimportant, especially as the commissions are ordinarily deducted from sales proceeds.

<sup>94</sup> See sec. 17 of Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>95</sup> *Farmers Union Cooperative Co. v. Commissioner*, 90 F. 2d 488, affirming 33 B. T. A. 225. See also *Maryland & Virginia Milk Producers' Association v. District of Columbia*, 119 F. 2d 787, cert. den. 314 U. S. 646, 62 S. Ct. 87, 86 L. Ed. 518.

<sup>96</sup> *Associated Fruit Co. v. Idaho-Oregon Fruit Growers' Association*, 44 Idaho 200, 256 P. 99, 100.

<sup>97</sup> *Texas Farm Bureau Cotton Association v. Lennox*, 117 Tex. 94, 297 S. W. 743. See also *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Burley Tobacco Growers Coop. Association v. Tipton*, 227 Ky. 297, 11 S. W. 2d 119; *Burley Tobacco Growers' Coop. Association v. Brown*, 229 Ky. 696, 17 S. W. 2d 1002.

<sup>98</sup> *Lambert v. Military Ridge Cheese Co.*, 179 Wis. 359, 191 N. W. 555; *Valley Butter Company v. Minnesota Cooperative Creameries' Association, Inc.*, 300 Pa. 102, 150 A. 157. For other cases announcing a similar principle see *Emigh v. Earling*, 134 Wis. 565, 115 N. W. 128, 27 L. R. A. (N. S.) 243, affirmed in 218 U. S. 27, 30 S. Ct. 672, 54 L. Ed. 915; *First National Bank of Elgin v. Kilbourne*, 127 Ill. 573, 20 N. E. 681, 11 Am. St. Rep. 174; *Cable v. Iowa State Savings Bank of Iowa*, 197 Iowa 393, 194 N. W. 957, 31 A. L. R. 748; *National Bank v. Ins. Co.*, 104 U. S. 54, 26 L. Ed. 693; *Union Stock Yards National Bank v. Gillespie*, 137 U. S. 411, 11 S. Ct. 118, 34 L. Ed. 724, 23 C. J. 352.

In California <sup>99</sup> it was held that raisins in the hands of a grower who was under contract to deliver them to an association could not be seized on account of debts of the grower, because title to the raisins had passed to the association. A somewhat similar holding was made in Texas.<sup>1</sup> Clearly if commodities may not be seized in the hands of a grower because title to them has passed to an association, it would seem to follow that they might be seized in the hands of an association to satisfy a claim against it.

The view that commodities received by an association under a marketing contract which purports to pass title thereto may not be seized by a creditor of the association appears to be based on the contention that the plan contemplated by the marketing contract is essentially agency, inasmuch as such contracts commonly provide for the association to sell the commodities covered thereby either separately or on a pool basis, make authorized deductions, and then account. No case to date apparently has passed on this specific point.<sup>2</sup> To support the view that title has not passed would demand a finding either that the parties did not intend that title would pass for any purpose or that it passed only insofar as this was necessary for business purposes. But as an association as agent may be authorized to do anything that is needful in the handling, processing and sale of agricultural products, it is difficult to see the justification for holding that a marketing contract that purports to pass title to commodities is only an agency contract. Clearly parties should be allowed to determine the character of a transaction into which they enter. It is true that deeds intended by the parties to be mortgages have been held to be such by the courts; but this is in accord with the intent of the parties, and not contrary thereto.<sup>3</sup>

The amount of all unauthorized deductions or withholdings may not properly be regarded as assets of an association; <sup>4</sup> and even when an association is operating under a purchase and sale contract, money in excess of authorized deductions, arising from the sale of commodities received by an association from its members for purposes of sale, does not constitute a part of the property of the association from the standpoint of a bylaw providing that on the termination of membership the interest of a member in the property of the association shall cease.<sup>5</sup> In other words, sums like those just referred to have the status of debts of the association; and, moreover, their retention is inconsistent with the nonprofit character of an association and the fiduciary relationship existing between an association and its members.

A cooperative may receive money from its members for a specific purpose in pursuance of definite agreements with respect thereto, which money does

<sup>99</sup> *Sun-Maid Raisin Growers of California v. Jones*, 96 Cal. App. 650, 274 P. 557, hearing denied by the State supreme court; *Merriman v. Martin*, 113 Cal. App. 167, 298 P. 95.

<sup>1</sup> *Texas Hay Association v. Angleton State Bank*, 291 S. W. 846 (Tex. Com. App.), reversing 285 S. W. 941.

<sup>2</sup> But see *Rhodes v. Little Falls Dairy Company, Inc.*, 230 App. Div. 571, 245 N. Y. S. 432, affirmed in 256 N. Y. 559, 177 N. E. 140; *City of Owensboro v. Dark Tobacco Growers' Association*, 222 Ky. 164, 300 S. W. 350; *Texas Farm Bureau Cotton Association v. Stovall*, 113 Tex. 273, 253 S. W. 1101, reversing 248 S. W. 1109 (Tex. Civ. App.); *Texas Certified Cottonseed Breeders' Association v. Aldridge*, 122 Tex. 464, 61 S. W. 2d 79, reversing 59 S. W. 2d 320 (Tex. Civ. App.); *Johnson v. Staple Cotton Coop. Association*, 142 Miss. 312, 107 So. 2.

<sup>3</sup> 41 C. J. 310-354.

<sup>4</sup> *Dryden Local Growers v. Dormaier*, 163 Wash. 648, 2 P. 2d 274.

<sup>5</sup> *Bogardus v. Santa Ana Walnut Growers' Association*, 41 Cal. App. 2d 939, 108 P. 2d 52; *Mountain View Walnut Growers Association v. California Walnut Growers Association*, 19 Cal. App. 2d 227, 65 P. 2d 80.

not become a part of its general assets. This is well illustrated by a case involving an organization formed by persons, engaged in the retail grocery business, to function on a cooperative basis in the wholesale handling of groceries. The association had a bylaw reading as follows:

One percent (1%) shall be added to all statements for the purpose of creating a credit reserve fund. Said one percent (1%) shall be credited to each member's reserve fund account and shall be returnable with interest upon the member ceasing to be a member of the association; less, however, a pro rata percentage of loss sustained by the association on account of losses or credit extended to members of the association.

The association went into bankruptcy and, although the assets of the association were insufficient to pay all its creditors in full, it was held that each of the members of the cooperative was entitled to have returned to him the balance remaining in his account which had been obtained in pursuance of the bylaw.<sup>6</sup>

On the other hand, when a corporation issued what was known as participating operation certificates for which the purchasers paid \$250 and which entitled them to receive \$500, to be paid out of funds obtained by setting aside in a bank 1 cent on each gallon of gasoline and 5 percent on all merchandise sold by each gasoline station concerned, it was held that amounts so set aside, but which were really under the control of the corporation, were part of the general assets of the corporation and were distributable only among creditors of the corporation, other than the holders of the certificates.<sup>7</sup>

If the statute of a State under which an association is incorporated specifically provides that the products delivered to an association by its members are liable for its debts, no reason is apparent why the statutory provision would not be given effect. And when an association incorporated under a Missouri statute provided that the liability of each member was limited to the amount due him by the association under its marketing contract, the fact that the association operated on an agency basis did not prevent the proceeds received from the sale of the products of members from being liable for its debts, to the extent that amounts were due the members from the association.<sup>8</sup> The fact that some of the members of this association had paid the association for the crates in connection with which the indebtedness arose did not prevent the proceeds received from the sale of their products from being liable for the indebtedness.

Ordinarily when goods are received on consignment the title to them is in the consignor and not in the consignee.<sup>9</sup> Under these circumstances the consignee actually has a right to sell the goods and to give a valid title thereto and the consignee is under obligation to account to the consignor. Of course, all such sales should be made in good faith and with a view to furthering the interest of the consignor.

In a case in which a cooperative handled fertilizer on a consignment basis, the consignor of the fertilizer was held entitled to sue a director for the purchase price of fertilizer when he attempted to offset a debt which

<sup>6</sup> *Warner v. Schoner*, 90 F. 2d 579. See also *Speh v. Bullard*, 90 F. 2d 227. But see *Maryland & Virginia Milk Producers' Association v. District of Columbia*, 119 F. 2d 787, cert. den. 314 U. S. 646, 62 S. Ct. 87, 86 L. Ed. 518.

<sup>7</sup> *United States & Mexican Oil Co. v. Keystone Auto Gas & Oil Service Co.*, 19 F. 2d 624. See also *Stephenson v. Go-Gas Company*, 268 N. Y. 372, 197 N. E. 317; *In re Hawkeye Oil Company*, 19 F. 2d 151.

<sup>8</sup> *Bank of Aurora v. Aurora Coop. Fruit Growing & Marketing Association*, 91 S. W. 2d 177 (Mo. App.).

<sup>9</sup> 55 C. J. 585; *State Tax Commission of Arizona v. Martin*, 57 Ariz. 283, 113 P. 2d 640.



the association owed him against a debt which he owed the association for fertilizer.<sup>10</sup>

A milk marketing association filed a claim as agent of its members for amounts due from a dairy company for milk in a proceedings arising from the company's assignment for the benefit of creditors. It was held that no rights were lost by including all such members' claims, assigned by them to the association, in one claim for a sum exceeding the maximum amount allowable under a preference statute on each claim.<sup>11</sup>

Although a corporation may have branch offices and various departments, it should be kept in mind at all times at least insofar as third persons are concerned, that all the assets of the corporation are available for the satisfaction of all of the debts of the corporation. In a Minnesota case,<sup>12</sup> it was said:

We think it needs no argument to demonstrate that a corporation cannot divide itself into several parts so that each segment will constitute a separate entity when dealing with the public. Possibly such an arrangement would be permissible where only the rights of consenting stockholders were involved.

Again, it should be kept in mind that a member or stockholder is a member or stockholder of the corporation and not of a particular store, branch, or department.

## Nonprofit Associations

**M**ANY of the cooperative marketing acts contain a provision reading substantially as follows:

Associations organized hereunder shall be deemed "nonprofit," inasmuch as they are not organized to make profit for themselves, as such, or for their members, as such, but only for their members as producers.<sup>13</sup>

The foregoing statement probably would not in and of itself cause an association to be classified as a nonprofit association.<sup>14</sup> On the other hand, if an association is formed and operated as a nonprofit association the statutory declaration should confirm its character.

In a Missouri case<sup>15</sup> a cooperative brought a suit to recover the balance alleged to be due for a carload of oranges. The defendant contended that the association was not entitled to maintain the suit because it was a foreign corporation which had no license to do business in Missouri. Under the Missouri statute, however, only corporations organized for pecuniary gain were required to obtain licenses to do business in the State. The court, after pointing out that the association was incorporated as a nonprofit cooperative corporation under the laws of California, referred to the statutory provision quoted above and held that the association was not "a corporation for pecuniary profit" within the meaning of the statute relative to foreign corporations.

<sup>10</sup> *Darling & Company v. Petri*, 138 Kan. 666, 27 P. 2d 255.

<sup>11</sup> *In re Merrick Dairy Co. of Beloit*, 249 Wis. 295, 24 N. W. 2d 679.

<sup>12</sup> *John H. Lebens, as Receiver of the Le Sueur County Cooperative Company v. Nelson*, 148 Minn. 240, 181 N. W. 350, 352.

<sup>13</sup> See sec. 2 of Bingham Cooperative Marketing Act of Kentucky, p. 301 of Appendix. In connection with this topic see note 1, p. 1.

<sup>14</sup> *Reis, Alvin C.*, COOPERATIVE LEGISLATION, American Cooperation, 1925, v. 1, pp. 325, 328, Washington, D. C.

<sup>15</sup> *Mutual Orange Distributors v. Black*, 221 Mo. App. 493, 287 S. W. 846. See also *Georgia Milk Producers Confederation v. City of Atlanta*, 185 Ga. 192, 194, S. E. 181; *American Cotton Coop. Association v. U. C. and Ware Co.*, 193 Miss. 43, 7 So. 2d 537.

In a West Virginia case<sup>16</sup> the court construed a statutory provision similar in effect to the one quoted above and said:

On the record before us it would seem that the plaintiff's prima facie status of being a non-profit association is probably overcome by the facts, in this, that through the processing of dairy products and the marketing of commodities produced therefrom, the association operates primarily for the purpose of deriving for its members a greater return than they could obtain from the raw products.

No basis is perceived for the view that an association ceases to be a non-profit association because it obtains greater returns for its members than they could obtain from their raw products. Insofar as it has any bearing on the matter, benefits received by the members of a cooperative in the form of increased returns on their products are evidence of its nonprofit character. The principal objective of a cooperative is to increase returns to its members. The situation insofar as an association formed and operating on an ideal basis is concerned is analogous to one in which an individual might act on a cost basis as the agent for farmers in disposing of their products or acquiring supplies for them. The agent would be acting on a nonprofit basis and financial benefits which he might be able to obtain for the farmers would not operate to change his status. Such an association, it has been held, is not in any commercial sense making a profit on the products received from its members.<sup>17</sup>

Fundamentally, the contractual obligation of a properly organized marketing cooperative is to return everything received for the products delivered by its members, less operating costs and expenses, and other authorized deductions for which, in many instances, the members receive credits. In other words, the making of profits which, in the discretion of management, may be passed on to its stockholders as furnishers of capital, is entirely foreign to the character of a true cooperative.

The fact that an association must have money to operate does not affect its nonprofit character.<sup>18</sup>

In a California case<sup>19</sup> it was said:

The plaintiff's existence as a nonprofit association does not in any wise militate against its right to claim the damages recovered. As a corporation considered singly, it designed to make no profit; the advantages, pecuniary and otherwise, resultant upon its operations, descended immediately to the cooperating stockholders. As an agency for the purpose of distributing this benefit in such manner, the corporation existed as such, and by its corporate name it was entitled to prosecute this action. As to whether it might, upon collecting the money, sequester it in a fund not contemplated by the terms of its articles, and so consummate an act ultra vires, is of no concern here.

Much confusion appears to have arisen with regard to the term "non-profit."<sup>20</sup> Obviously, as indicated in the foregoing quotation and as aptly

<sup>16</sup> *Sanitary Milk & Ice Cream Co. v. Hickman*, 119 W. Va. 351, 193 S. E. 553, 555. See also *Storen v. Jasper County Farm Bureau Cooperative Association*, 103 Ind. App. 77, 2 N. E. 2d 432.

<sup>17</sup> *Yakima Fruit Growers' Association v. Henneford*, 182 Wash. 437, 47 P. 2d 831, 100 A. L. R. 435.

<sup>18</sup> *Ex parte Baldwin County Producers' Corporation*, 203 Ala. 345, 83 So. 69. See also *Tobacco Growers' Cooperative Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231; *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311.

<sup>19</sup> *Anaheim Citrus Fruit Association v. Yeoman*, 51 Cal. App. 759, 197 P. 959, 961.

<sup>20</sup> Hanna, John, *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS*, 509 pp. New York, 1931. See p. 50. See also: Cerini, Floyd B. *UTAH PIONEERS IN ADOPTING THE UNIFORM COOPERATIVE ASSOCIATION STATUTES*. *Cooperative Journal* 41-49. 1938.

pointed out both by text writers<sup>21</sup> and by the courts,<sup>22</sup> cooperatives are business organizations and are intended to increase the returns to farmer members for their products. A cooperative is truly "nonprofit" when by reason of its prior contract with patrons it is required to distribute to such patrons on a patronage basis all "profits" derived from transactions with them.

It has been said that:

Obviously, the cooperative marketing association is organized for profit in the sense of financial benefit to its members. The element of departure from ordinary corporate economic practice is found in the fact that the financial gain is enjoyed by the members in proportion to the production, by each, of the products handled, rather than in proportion to the capital otherwise contributed by each to the conduct of the business; but this difference of economic principle governing the distribution of wealth cannot alter the fact that the sole incentive to membership in such an association is the financial benefit to be derived therefrom in the marketing of the farm products which the member is producing. There is nothing broadly eleemosynary in cooperative associations. They simply represent a banding together of producers for their common good, and the motive of each is pecuniary gain.<sup>23</sup>

A person engaged in a normal commercial merchandising business buys goods from sellers and then resells them at higher prices but he is under no obligation to account to the seller for the profits made on such transactions; in other words, a person engaged in such a merchandising business is operating for entrepreneur profit. This is in sharp contrast with the situation of a marketing cooperative which is required to account to its members for the full net amount it receives for commodities delivered by them. Likewise, a farm supply association which is required to account to its members for any net margins realized on goods supplied by the association, is not in business for the purpose of producing an entrepreneur profit.

The nonprofit or mutual character of cooperatives is also recognized in the cases in which associations are permitted to recover from members and others overadvances that have been made on commodities.<sup>24</sup> Obviously, if some patrons receive excess payments, other patrons must necessarily receive less than their fair share, because the association usually has no "profits" to absorb the operating loss created by the overpayments.

Savings effected by a cooperative, even though they "belong" to members and not to the association itself, are subject to the claims of the creditors of the association,<sup>25</sup> and the mere fact that a cooperative is a nonprofit organization is not sufficient to exempt it, under certain statutes, from license taxes.<sup>26</sup>

The term "nonprofit" is also applicable to associations organized under statutes which do not contain a provision like the one under discussion if, in fact, they are operating on such a basis.<sup>27</sup>

<sup>21</sup> Evans, Frank, and Stokdyk, E. A. *THE LAW OF AGRICULTURAL COOPERATIVE MARKETING*. 648 pp. Rochester, N. Y. 1937. See p. 303.

<sup>22</sup> *Schuster v. Ohio Farmers' Cooperative Milk Association*, 61 F. 2d 337.

<sup>23</sup> *Schuster v. Ohio Farmers' Cooperative Milk Association*, 61 F. 2d 337, 338. See also *In re Wisconsin Cooperative Milk Pool*, 35 F. Supp. 787 reversed in 119 F. 2d 999.

<sup>24</sup> *Baird v. Gleason*, 53 F. 2d 785. See also p. 115.

<sup>25</sup> *Associated Fruit Co. v. Idaho-Oregon Fruit Growers' Association*, 44 Idaho 200, 256 P. 99.

<sup>26</sup> *Appeal of Beaver County Coop. Association*, 118 Pa. Super. 305, 180 A. 98. See also *Maryland & Virginia Milk Producers' Association v. District of Columbia*, 119 F. 2d 787, cert. den. 314 U. S. 646, 62 S. Ct. 87, 86 L. Ed. 518.

<sup>27</sup> *Uniform Printing and Supply Co. v. Commissioner*, 88 F. 2d 75.



## Equality of Treatment

BROADLY speaking, all members of a cooperative who are similarly situated should receive similar treatment. There may be differentials based on time, distance, grade and quality of products and other factors; but, at least in the absence of definite provisions to the contrary, where the conditions are identical the treatment should be identical. In a case involving a mutual insurance company it was said: <sup>28</sup>

\* \* \* we think it must be conceded that in a mutual company, where the members are not divided into classes except as to age, the company would have no authority, for the same premium, to issue policies promising special benefits to different members of the same class.

Although in an agricultural marketing or farm supply association the foregoing statement would not appear to be strictly applicable, it is indicative of a principle which should be kept in mind.

In California, on account of a statute which was construed to permit the unequal treatment of members, a marketing contract which favored a particular type of member was upheld; <sup>29</sup> but the court pointed out that before the amendment of the statute "it was believed that such associations should deal only with the products of its members, and that all members should be treated equally." Sometimes an association will provide in its marketing contract that if in the future it offers a different form of marketing contract to other producers it will give those producers who signed the original marketing contract an opportunity to sign the new form.

In a Maryland case <sup>30</sup> the court said that it found nothing in the Maryland statutes, in a milk marketing association's charter, or in its marketing contract, which required that the association's "duty of equality in treatment of its members limited it to one uniform contract with all its members for a single activity." Also, in a case <sup>31</sup> involving a creamery association operating in California, the court held that there was nothing in the bylaws, articles, or any contract of the creamery which bound the association to take, or any member of the association to deliver, milk. Accordingly, the court said, the association was free to deal with its members on any reasonable basis, and, in doing so, it could apply different conditions of purchase as to members, if, in the interest of the association, there existed reasonable and natural grounds for such varying conditions. The court said, "it could not unfairly discriminate but it could discriminate." Aside from the rather complicated details of these particular cases, some doubts would surely arise as to whether equity is properly served where a cooperative actually pays two rates of return simultaneously for identical products, unless some specific justification for the difference is involved.

In a Wisconsin case involving a milk bargaining association the court said: <sup>32</sup>

<sup>28</sup> *Durland v. Elkhorn Life & Accident Insurance Company*, 112 Neb. 105, 198 N. W. 564, 566.

<sup>29</sup> *California Canning Peach Growers v. Harkey*, 11 Cal. 2d 188, 78 P. 2d 1137. See also *California Canning Peach Growers v. Williams*, 11 Cal. 2d 221, 78 P. 2d 1154, 11 Cal. 2d 233, 78 P. 2d 1161; *Stafford v. California Canning Peach Growers*, 11 Cal. 2d 212, 78 P. 2d 1150.

<sup>30</sup> *Cooperative Milk Service, Inc. v. Hepner*, 198 Md. 104, 81 A. 2d 219.

<sup>31</sup> *Bertram v. Danish Creamery Association*, 120 Cal. App. 2d 458, 261 P. 2d 349.

<sup>32</sup> *Wheelwright v. Pure Milk Association*, 208 Wis. 40, 240 N. W. 769, 242 N. W. 486, 487.

It does not follow, if the extrinsic evidence should establish this as the sense in which the language should be taken, that the association can deliberately or intentionally eliminate from the market a portion of the producers who are members in order that the remaining members may enjoy more favorable prices. The contract is not open to such a construction. Even though the sense or meaning contended for should be established, the association is obligated to exercise the same diligence and good faith to market the milk of one member that it exercises to market the milk of the other members. This is the cooperative principle as applied to this type of organization. It is violated when and if the association discriminates in the exercise of its sales efforts between members or groups of members, each of whom has an equal right to the exercise of these efforts. It is not violated if the association has exercised reasonable diligence in good faith and without discrimination.

It has been held that where a cooperative orally modified its marketing agreement with a member to guarantee him a minimum price for his product, the association was obligated to comply with its agreement.<sup>33</sup>

In a case decided by the Board of Tax Appeals it appeared that a group of patrons was given a marked preference in that the supplies which they purchased were apparently purchased at cost.<sup>34</sup> In this connection the court said:

Not only did this preferred group contribute nothing to petitioner's profits or to defray its necessary expenses, but the three shareholders in that group received stock dividends out of petitioner's profits from sales to other patrons at regular retail prices. The evidence negatives the fact that petitioner was operated on a cooperative basis, either as among its members alone, or as between its members and nonmembers.

In a case<sup>35</sup> involving a mutual insurance company it appeared that the company decided to dissolve and to distribute the money which it had on hand. A question arose as to who was entitled to share in the distribution. In holding that all policyholders who had contributed to the amount then on hand were entitled to share in the distribution, the court said:

Clearly, if the court allows the present policyholders to take all the surplus, it will be permitting the contributions of many to benefit the few. What was the contract? It was a mutual obligation to share losses by fire; and, to make the contract as absolutely certain as possible, the amount supposed to be necessary for that purpose was required to be paid in advance. But a mutual obligation to share losses was not all. This mutuality extended to an equal distribution of any surplus. The cash paid or advanced was not paid to protect some future policyholder against loss, or to enable him to draw out of the treasury more than all his premiums, but simply to insure the existing policyholders against loss. That is the venture; that is the contract. The members for the time being bind themselves each to the other only; not to any third persons; not to those who may become members afterwards, and when their policy shall have expired. The money paid by the members for the time being is a trust fund, held for themselves only, and to divert it to the profit of others is a plain breach of trust.

## Nonmember Business

WHILE the various Federal statutes applicable to agricultural cooperatives evince a uniform public policy with respect to the subject of nonmember business this is not true of the State cooperative acts. Some of these acts are silent with respect to nonmember business and if an association is incorporated under such a statute it would appear that it may freely transact business with members and nonmembers without restriction,<sup>36</sup> insofar as State law is concerned. Generally, however, State statutes either prohibit an association from doing business with nonmembers, or

<sup>33</sup> *Yakima Fruit Growers' Association v. Hall*, 180 Wash. 365, 40 P. 2d 123.

<sup>34</sup> *Farmers Union Cooperative Oil Company*, 38 B. T. A. 64.

<sup>35</sup> *Smith v. Hunterdon County Mutual Fire Insurance Company*, 41 N. J. Eq. 473, 4 A. 652, 653. Cf. *Driscoll v. Washington County Fire Insurance Co.*, 110 F. 2d 485.

<sup>36</sup> *In re Farmers' Dairy Company's Receivership*, 177 Minn. 211, 225 N. W. 22.

permit associations organized under them to transact business with nonmembers but provide that the business done with nonmembers shall not exceed in value the amount of business transacted for members. This limitation on nonmember business appears in the Capper-Volstead Act,<sup>37</sup> the Agricultural Marketing Agreements Act,<sup>38</sup> as amended, and also Section 521 of the Internal Revenue Code of 1954, which contains the requirements that must be met if a cooperative is to have an "exempt" status for Federal income tax purposes.<sup>39</sup>

Likewise, associations that do more business with nonmembers than with members are not regarded as producer cooperatives under marketing agreements entered into under the Agricultural Marketing Agreement Act,<sup>40</sup> as the Department of Agriculture gives consideration to the conditions of the Capper-Volstead Act in determining whether an organization is an association of producers.

Serious consequences may result if an association violates a restriction on the amount of business which it may do for nonmembers.<sup>41</sup>

If the value of the business transacted by an association with nonmembers exceeds that transacted with members, it is not eligible for loans from a bank for cooperatives,<sup>42</sup> nor could it qualify for the restricted exemption provided for in the Motor Carrier Act.<sup>43</sup>

In certain types of cooperatives the necessity for limiting the advantages afforded by the association strictly to its own members is apparent. This point is illustrated by community groups.<sup>44</sup> Similarly mutual insurance companies and irrigation companies usually limit their business to their members. In addition, in the case of mutual water companies, membership in the association and the right to a supply of water are frequently appurtenant to the land.<sup>45</sup> However, this is not necessarily the case.<sup>46</sup>

An association which is to act as a public warehouseman must ordinarily, in order to operate as a public warehouse, offer storage facilities to the public generally and may not limit it to its own membership.<sup>47</sup> It has also been held that a mutual telephone company is under a duty to serve the public at large.<sup>48</sup>

If an association is to maintain an "exempt" status under the Federal income tax laws, it must treat member and nonmember patrons alike and may not, for instance, limit patronage refunds to members or pay patronage

<sup>37</sup> Capper-Volstead Act, p. 166.

<sup>38</sup> Federal Statutes Mentioning Cooperatives, p. 247.

<sup>39</sup> See Federal Income Taxes, p. 195.

<sup>40</sup> *Ibid.*, n. 36.

<sup>41</sup> *United States v. American Livestock Commission Co.*, 279 U. S. 435, 49 S. Ct. 425, 73 L. Ed. 787. See also *Board of Trade of City of Chicago v. Wallace*, 67 F. 2d 402.

<sup>42</sup> Federal Statutes Mentioning Cooperatives, p. 247.

<sup>43</sup> Regulatory Statutes, p. 251.

<sup>44</sup> *Burt v. Oneida Community, Ltd.*, 137 N. Y. 346, 33 N. E. 307, 19 L. R. A. 297; 138 N. Y. 649, 34 N. E. 288.

<sup>45</sup> *Comstock v. Olney Springs Drainage District*, 97 Colo. 416, 50 P. 2d 531; *Woodstone Marble & Tile Co. v. Dunsmore Canyon Water Co.*, 47 Cal. App. 72, 190 P. 213.

<sup>46</sup> *Palo Verde Land & Water Company v. Edwards*, 82 Cal. 52, 254 P. 922. But see *People ex rel. Knowlton v. Orange County Farmers' and Merchants' Association*, 56 Cal. App. 205, 204 P. 873.

<sup>47</sup> *Nash v. Page & Co.*, 80 Ky. 539, 4 Ky. Law Rep. 477, 44 Am. Rep. 490.

<sup>48</sup> *Celina & Mercer County Telephone Company v. Union-Center Mutual Telephone Association*, 102 Ohio St. 487, 133 N. E. 540, 21 A. L. R. 1145. But see *State v. Southern Elkhorn Telephone Co.*, 106 Neb. 342, 183 N. W. 562; *State ex rel. Lohman & Farmers' Mut. Telephone Co. v. Brown*, 323 Mo. 818, 19 S. W. 2d 1048; *Inland Empire Rural Electrification, Inc. v. Department of Public Service of Washington*, 199 Wash. 527, 92 P. 2d 258.



refunds to nonmembers computed at a lower rate than those paid to members.<sup>49</sup> Some State statutes, however, provide that although associations may do nonmember business, patronage refunds may be paid only to members or that patronage refunds to nonmembers must be computed at a lower rate than such refunds paid to members.

While it would seem on principle that an association from a cooperative standpoint should accord the same treatment to all patrons regardless of whether they are members, some associations feel that if nonmember patrons receive the same treatment as member patrons there is no particular incentive for a nonmember to become a member of the association. In order to modify this situation the bylaws of many associations provide that the patronage refunds which accrue to the credit of an eligible nonmember patron shall be applied first toward the purchase of a membership or a share of stock. In the case of agricultural cooperatives which limit their membership to producers, it may happen that some business may be transacted for persons who are ineligible for membership. This is particularly true in the case of associations performing farm business services. As brought out in the discussion of Federal income taxes, an association may not do more than 15 percent of its farm supply business with patrons who are neither members nor producers, if it is to be eligible for an "exempt" status under the Federal income tax law.

## Control of Crops by Landlord

THE statutes of a number of States contain a provision reading as follows:

In any action upon such marketing agreements, it shall be conclusively presumed that a landowner or landlord or lessor is able to control the delivery of products produced on his land by tenants or others, whose tenancy or possession or work on such land or the terms of whose tenancy or possession or labor thereon were created or changed after execution by the landowner or landlord or lessor, of such a marketing agreement; and in such actions, the foregoing remedies for nondelivery or breach shall lie and be enforceable against such landowner, landlord or lessor.<sup>50</sup>

Entirely independent of the conclusive-presumption provision just quoted, may an association require that crops grown under the share-lease plan be marketed through it? An association could include a provision in its marketing contract requiring a member, if he leased his farm or any part thereof after signing the marketing contract, to include a provision in the lease stipulating that all crops grown on the farm should be marketed through the association. In addition, a provision could be included requiring the landlord to pay liquidated damages for his failure to have the share of the crops belonging to his tenant marketed through the association.<sup>51</sup> If a lease provides for a share tenancy, then, regardless of the time that it is entered into, the association clearly would be entitled to receive at least the landlord's share of the crop for marketing, because he has legal control over that portion of the crop.<sup>52</sup>

In the cases just cited it appeared that the tenants had the right to sell the landlord's part of the cotton crop, but it was held in each case that

<sup>49</sup> See Federal Income Taxes, p. 195.

<sup>50</sup> See sec. 18 of Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>51</sup> *Dark Tobacco Growers' Coop. Association v. Daniels*, 215 Ky. 67, 284 S. W. 399. See Liquidated Damages, p. 139.

<sup>52</sup> *Long v. Texas Farm Bureau Cotton Association*, 270 S. W. 561 (Tex. Civ. App.); *Main v. Texas Farm Bureau Cotton Association*, 271 S. W. 178 (Tex. Civ. App.).

this fact was immaterial, as the leases provided that the landlord receive a part of the crop as his rent.

In North Carolina it was held that a landlord was not liable for damages to the association because of the failure of his tenant to market his share of the crop through the association.<sup>53</sup> The North Carolina cooperative statute does not contain the conclusive-presumption provision.

In the absence of a provision in the marketing contract requiring a landlord to have the share of the crops belonging to his tenants marketed through an association and in the absence of a conclusive-presumption provision in the cooperative act of the State, it would appear that there is no basis for holding a landlord liable on account of the fact that the share of the crops of his tenants is not marketed through the association, nor would there be a basis for holding the tenants liable unless they are parties to the contract.

## Crop Mortgages

TO OBTAIN a valid lien statutory requirements must be met and, if the statute requires verification under oath, an acknowledgment is insufficient.<sup>54</sup> In taking a crop lien or other mortgage, care should be taken to identify clearly the property covered and the indebtedness secured, otherwise the lien may fail.<sup>55</sup>

Generally, a person who takes a crop mortgage or other lien on commodities occupies a position virtually identical with that of a purchaser of the commodities involved. In other words, in determining the rights of the holder of a crop mortgage to avail himself of the products covered thereby, the rules that would be applicable if he had purchased the crop involved are applicable. As it is the general rule that any interest which a person has in property may be mortgaged, a person entitled to a share of the crop may give a mortgage thereon covering his interest.<sup>56</sup>

Marketing contracts sometimes provide that, if the member places a crop mortgage upon any of his crops during the term of the contract, the association has the right to take delivery of the crop and to pay off all or any part of the crop mortgage for the account of the grower. Such provisions are at least binding on the member and the association.<sup>57</sup>

In a Mississippi case<sup>58</sup> it was held that, where an association had agreed with a member that the proceeds arising from the sale of the commodities covered by its marketing contract would be turned over to the holder of a mortgage on the commodities until the mortgage was fully satisfied, this agreement operated to prevent a creditor of the member from successfully maintaining garnishment proceedings against the association.

In Kansas,<sup>59</sup> Kentucky,<sup>60</sup> and Tennessee,<sup>61</sup> it has been held independent

<sup>53</sup> *Tobacco Growers' Coop. Association v. Bissett*, 187 N. C. 180, 121 S. E. 446.

<sup>54</sup> *Reeves v. Kansas Cooperative Wheat Marketing Association*, 136 Kan. 306, 15 P. 2d 446.

<sup>55</sup> *Dingfelder v. Georgia Peach Growers Exchange*, 184 Ga. 569, 192 S. E. 188.

<sup>56</sup> *Merriman v. Martin*, 113 Cal. App. 167, 298 P. 95.

<sup>57</sup> *Lennox v. Texas Cotton Coop. Association*, 55 S. W. 2d 543 (Tex. Com. App.).

<sup>58</sup> *Cole-McIntyre-Norfleet Company v. DuBard*, 135 Miss. 20, 99 So. 474; *Myers v. Bushmiera*, 201 Ark. 564, 145 S. W. 2d 722.

<sup>59</sup> *Kansas Wheat Growers' Association v. Floyd*, and *Kansas Wheat Growers' Association v. Robben*, 116 Kan. 522, 227 P. 336.

<sup>60</sup> *Redford v. Burley Tobacco Growers' Coop. Association*, 205 Ky. 515, 266 S. W. 24; *Feagain v. Dark Tobacco Growers' Coop. Association*, 202 Ky- 801, 261 S. W. 607.

<sup>61</sup> *Dark Tobacco Growers' Coop. Association v. Dunn*, 150 Tenn. 614, 266 S. W. 308. See also *Oregon Growers' Coop. Association v. Lentz*, 107 Ore. 561, 212 P. 811; *Monte Vista Potato Growers' Coop. Association v. Bond*, 80 Colo. 516, 252 P. 813.

of statute that the person who takes a mortgage on a crop with knowledge of the fact that it is covered by a marketing contract may be compelled by injunction to market the crop through the association, which in turn after making the deductions authorized by the contract must account to the person holding the mortgage before making any payments to the member.

In North Carolina,<sup>62</sup> Alabama,<sup>63</sup> and Louisiana,<sup>64</sup> it has been held that even though the party taking the mortgage has knowledge at the time that the crop is covered by a marketing contract, his rights are superior to those of the association, and the association cannot compel the delivery of the crop to it for marketing. It is believed that the holdings in the North Carolina, Alabama, and Louisiana cases were based, to a large extent at least, on the mandatory character of the statutes of those States defining the superiority of recorded liens and mortgages.

In a Texas case in which a chattel mortgage was taken on a crop of rice with knowledge that the mortgagor had contracted to deliver the rice to a cooperative, it was held that the rights of the association and of a buyer of such rice from the association were junior to those of the mortgagee.<sup>65</sup>

Another factor which should be considered in all these cases is the exact character of the purchase-and-sale contract of the association. If the contract is merely an executory contract to sell,<sup>66</sup> then the rights of the association may be different from what they would be if the contract were one for a present sale of future crops.

In North Carolina, the fact that the crop is covered by a mortgage does not prevent the association from enjoining the member from disposing of his crop outside the association subject to the right of the holder of the mortgage to demand a sufficient amount of the crop to satisfy his mortgage,<sup>67</sup> but it is otherwise in Alabama.<sup>68</sup>

In Kansas,<sup>69</sup> it was held that where a producer signed a marketing contract which in effect stated that there were no encumbrances of any kind against his crop, he was liable for liquidated damages to the association if delivery of his crop was prevented by a mortgage executed prior to the signing of the marketing contract, and in all cases liquidated damages may be recovered by an association (if the contract contains no exception), although delivery of the crop is prevented by a crop mortgage.<sup>70</sup>

If a cooperative in any State receives a crop on which a third person has a superior claim, the association runs a risk in receiving and handling the crop. If the person having a superior claim consents to having the association handle the crop, then there is no danger. In all cases in which an association receives a crop on which there is a lien or crop mortgage, great

<sup>62</sup> *Tobacco Growers' Coop. Association v. Harvey & Son Co.*, 189 N. C. 494, 127 S. E. 545, 47 A. L. R. 928; *Tobacco Growers' Coop. Association v. Patterson*, 187 N. C. 252, 121 S. E. 631.

<sup>63</sup> *Bishop v. Alabama Farm Bureau Cotton Association*, 215 Ala. 388, 110 So. 711.

<sup>64</sup> *Louisiana Farm Bureau Cotton Growers' Coop. Association v. Clark*, 160 La. 294, 107 So. 115.

<sup>65</sup> *Beaumont Rice Mills v. Dishman*, 72 S. W. 2d 365 (Tex. Civ. App.).

<sup>66</sup> *Tobacco Growers' Coop. Association v. Harvey & Son Co.*, 189 N. C. 494, 127 S. E. 545, 47 A. L. R. 928.

<sup>67</sup> *Tobacco Growers' Coop. Association v. Patterson*, 187 N. C. 252, 121 S. E. 631.

<sup>68</sup> *Bishop v. Alabama Farm Bureau Cotton Association*, 215 Ala. 388, 110 So. 711.

<sup>69</sup> *Kansas Wheat Growers' Association v. Leslie*, 126 Kan. 694, 271 P. 284.

<sup>70</sup> *Kansas Wheat Growers' Association v. Ast*, 118 Kan. 247, 234 P. 963; *North Carolina Cotton Growers' Coop. Association v. Bullock*, 191 N. C. 464, 132 S. E. 154, 47 A. L. R. 924; *Lennox v. Texas Farm Bureau Cotton Association*, 16 S. W. 2d 413 (Tex. Civ. App.).



care should be exercised to account to the holder of the lien or mortgage before making any payments to the grower. This is true whether or not the claim of the association is superior to the claim of the holder of the lien or mortgage.

An association is liable for conversion if it handles and sells a crop on which a third person has a superior lien, without the consent of that person.<sup>71</sup>

Where the mortgagee expressly or impliedly consents to the sale, however, the usual rule is that he thereby waives the lien of his mortgage and the purchaser is not liable for conversion.<sup>72</sup>

Even though the claim of the association is superior, if the association has knowledge of the crop lien or mortgage, then it should account to the holder thereof before making payment to the grower. An association ordinarily is free to take a mortgage on any property of a member including a crop to secure it for advances made or to be made.

If there is a lien on commodities the fact that they are shipped from another State is, generally speaking, immaterial because an association is charged by law with knowledge of a chattel mortgage that is duly filed of record in that State.<sup>73</sup>

The fact that delivery of commodities to an association is effected by the delivery of warehouse receipts therefor does not operate to improve the position of the association if the member did not have title to the commodities, or if a third person had a lien thereon.<sup>74</sup> But where warehouse receipts which under State statute the issuing warehouseman had an absolute duty to take up and cancel upon delivery of the commodity to the holder of the receipt were dishonestly used by the warehouseman's agent to obtain funds from a cooperative, it was held that the cooperative was an innocent purchaser and could recover from the warehouseman.<sup>75</sup>

In order to protect itself, an association may refuse to pay over the sales proceeds of a crop to a mortgagee where other lienors are questioning the right of the mortgagee to such funds, unless a suitable bond is furnished.<sup>76</sup>

If a member of an association suffers a loss by reason of the fact that the association has paid money, derived from the sale of his products, to a person on the false assumption that that person had a chattel mortgage on the products, the association is liable therefor.<sup>77</sup>

It should not be assumed that because an association does work upon commodities which it has received and which are covered by a chattel

<sup>71</sup> *Producers' Livestock Marketing Association v. Livingston*, 216 Iowa 1257, 250 N. W. 602; *Mississippi Cooperative Cotton Association v. Walker*, 186 Miss. 870, 192 So. 303; *Mason City Production Credit Association v. Sig Ellingson & Company*, 205 Minn. 537, 286 N. W. 713, certiorari denied 308 U. S. 599, 60 S. Ct. 130, 84 L. Ed. 501; *Alexandria Production Credit Association v. Horn*, 199 So. 430 (La. App.).

<sup>72</sup> *East Central Fruit Growers Production Credit Association v. Zuritsky*, 346 Pa. 335, 30 A. 2d 133; *Prichard v. Farmers Coop. Soc. No. 1 of Merkel*, 183 S. W. 2d 240 (Tex. Civ. App.); *Producers' Livestock Marketing Association v. John Morrell & Co.*, 220 Iowa 948, 263 N. W. 242; *Farmers National Grain Corporation v. Kirkendall*, 183 Okla. 17, 79 P. 2d 570.

<sup>73</sup> *Mason City Production Credit Association v. Sig Ellingson & Company*, 205 Minn. 537, 286 N. W. 713, certiorari denied 308 U. S. 599, 60 S. Ct. 130, 84 L. Ed. 501.

<sup>74</sup> *Gillon v. Martin*, 15 La. App. 366, 131 So. 598; *Four County Agricultural Credit Corporation v. Satterfield*, 218 N. C. 298, 10 S. E. 2d 914.

<sup>75</sup> *American Cotton Coop. Association v. U. C. and Ware Co.*, 193 Miss. 43, 7 So. 2d 537.

<sup>76</sup> *Farmers' Cooperative Elevator Company v. Schweigert-Ewald Lumber Company*, 60 N. D. 236, 233 N. W. 902.

<sup>77</sup> *White v. Lone Star Wool-Mohair Cooperative Association*, 95 S. W. 2d 178 (Tex. Civ. App.).

mortgage, that the association will be entitled to reimbursement therefor. In a Massachusetts case <sup>78</sup> in which a chattel mortgage was taken in good faith and without knowledge of the fact that the mortgagor was obligated to deliver the tobacco to an association which functioned on an agency basis, the rights of the mortgagees were prior to those of the association. Following the foreclosure of the mortgage on the tobacco, the association sold the tobacco and deducted certain expenses pursuant to an agreement between the parties, but as the remaining proceeds were no more than sufficient to pay the mortgagees it was held that the association had no right to deduct for indebtedness of the mortgagor to it on account of expenses incurred by the association, in sorting and curing the tobacco without authority from the mortgagees.

When commodities are delivered to a market agency with the consent of the holder of a lien thereon, the market agency has a factor's lien on the commodities and the proceeds derived therefrom for its reasonable commissions and expenses incident to the sale of the commodities.<sup>79</sup>

In many jurisdictions if a mortgagor is permitted to retain proceeds arising from the sale of mortgaged chattels without applying the proceeds on the indebtedness secured by the mortgage, the mortgage is invalid insofar as other creditors and subsequent purchasers in good faith are concerned.<sup>80</sup>

An association which held a chattel mortgage on hay took a bill of sale on the hay and later attempted to foreclose its mortgage; but the court said: <sup>81</sup>

When appellant took complete title, it merged the mortgage in the title. Appellant cannot stand in both positions, mortgagee and owner.

In many of the States it is a crime for a mortgagor to sell mortgaged property without the consent of the mortgagee.<sup>82</sup>

## Liquidated Damages

**L**IQUIDATED damages are damages the amount of which has been determined in advance by agreement between the parties. Long before the days of Blackstone, parties inserted in their contracts provisions that one should pay a certain sum, in case he breached the contract, to the other as satisfaction for the loss sustained because of the breach. One of the most common expressions used in discussing the term "liquidated damages" is "penalty." And it is frequently said that a penalty cannot be recovered, but that liquidated damages may be. A penalty may, in this connection, be defined as an amount fixed by the parties to a contract to be paid by one of them in case of breach, which is greatly or perhaps grossly in excess of the damages which may actually be suffered from such a breach. When the amount fixed is held to be a penalty, such amount cannot be recovered but only the actual damages suffered.

A case which well illustrates this view is one in which the defendant entered into a bond to pay \$10,000 in case he failed to secure releases, within a year, from certain parties having claims against him. One of the claims

<sup>78</sup> *West Springfield Trust Company v. Hinckley and the Hampden County Tobacco Growers' Association*, 258 Mass. 157, 154 N. E. 580.

<sup>79</sup> *Wenatchee Production Credit Association v. Pacific Fruit & Produce Company*, 199 Wash. 651, 92 P. 2d 883.

<sup>80</sup> *Turk v. Kramer*, 138 Okla. 35, 280 P. 266, 73 A. L. R. 229.

<sup>81</sup> *Northwest Hay Association v. Slayton*, 137 Wash. 248, 242 P. 354, 356.

<sup>82</sup> *Baumont Rice Mills v. Dishman*, 72 S. W. 2d 365 (Tex. Civ. App.); *Burns v. Clarksdale Production Credit Association*, 189 Miss. 34, 195 So. 588; 11 C. J. 638.

amounted to only \$9.80, and failure to obtain a release of this claim would have made the entire amount of the bond due and payable. The Supreme Court held that the \$10,000 was a penalty and not liquidated damages, and a judgment for 1 cent was affirmed.<sup>83</sup>

That the parties to a contract have described the amount to be paid in case of a breach as "liquidated damages" or as a "penalty" is not conclusive upon the point,<sup>84</sup> although the term used by the parties has been held to have some weight.<sup>85</sup> It has been held that the word "fine" was intended by the parties to a contract to mean "liquidated damages."<sup>86</sup>

In a certain case the defendant hired a yacht for 4 months for \$10,000 and agreed, in the event he failed to return it, to pay \$75,000, which was stated to be the value of the yacht for the purpose of the contract. The yacht was destroyed, and suit was brought for the recovery of the \$75,000. The Supreme Court affirmed a judgment for this amount and, in doing so, said in part:

\* \* \* whether a particular stipulation to pay a sum of money is to be treated as a penalty, or as an agreed ascertainment of damages, is to be determined by the contract, fairly construed, it being the duty of the court always, where the damages are uncertain and have been liquidated by an agreement, to enforce the contract.<sup>87</sup>

In 1904 an agreement was entered into for the erection of two laboratory buildings for the Department of Agriculture in Washington. The contract called for the completion of the buildings in 30 months, and for a delay of 101 days beyond the contract period the Government deducted \$200 a day, the amount stipulated in the contract as liquidated damages, a total of \$20,200. Later, suit was brought against the Government for the recovery of this amount. In holding that no recovery could be had, the Supreme Court of the United States said: <sup>88</sup>

\* \* \* courts will endeavor, by a construction of the agreement which the parties have made, to ascertain what their intention was when they inserted such a stipulation for payment, of a designated sum or upon a designated basis, for a breach of a covenant of their contract, precisely as they seek for the intention of the parties in other respects. When that intention is clearly ascertainable from the writing, effect will be given to the provision, as freely as to any other, where the damages are uncertain in nature or amount or are difficult of ascertainment or where the amount stipulated for is not so extravagant, or disproportionate to the amount of property loss, as to show that compensation was not the object aimed at or as to imply fraud, mistake, circumvention, or oppression. There is no sound reason why persons competent and free to contract may not agree upon this subject as fully as upon any other, or why their agreement, when fairly and understandingly entered into with a view to just compensation for the anticipated loss, should not be enforced.

The foregoing quotation expresses the common law relative to liquidated damages.

In a number of cases involving cooperatives, the courts have found that at common law they were entitled to liquidated damages.<sup>89</sup> On the other

<sup>83</sup> *Bignall v. Gould*, 119 U. S. 495, 7 S. Ct. 294, 30 L. Ed. 491.

<sup>84</sup> *Northwestern Terra Cotta Co. v. Caldwell*, 234 F. 491, 496.

<sup>85</sup> *Tayloe v. T. & S. Sandiford*, 20 U. S. 13, 5 L. Ed. 384.

<sup>86</sup> *United Farmers Association of California v. Klein*, 41 Cal. App. 2d 766, 107 P. 2d 631.

<sup>87</sup> *Sun Printing and Publishing Association v. Moore*, 183 U. S. 642, 662, 22 S. Ct. 240, 46 L. Ed. 366.

<sup>88</sup> *Wise (Trustee in Bankruptcy of Stannard) v. United States*, 249 U. S. 361, 365, 39 S. Ct. 303, 63 L. Ed. 647.

<sup>89</sup> *Burley Tobacco Society v. Gillaspay*, 51 Ind. App. 583, 100 N. E. 89; *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231; *Ex parte Baldwin County Producers' Corporation*, 203 Ala. 345, 83 So. 69; *Washington Coop. Egg & Poultry Association v. Taylor*, 122 Wash. 466, 210 P. 806; *Bull-*



hand, in a number of cases it was held that at common law provisions in bylaws or contracts providing for the payment by members of stipulated sums, in the event they failed to market their products or livestock through the association, were unlawful as they were deemed to be in restraint of trade.<sup>90</sup>

The bylaws in the Iowa case first cited provided that any member of the association should forfeit 5 cents for every hundredweight of produce or livestock sold to any competitor of the association. The association bought and sold the produce and livestock of nonmembers in addition to that of members. The bylaw, on its face, was aimed at competitors of the association and did not disclose that its purpose was the maintenance and upkeep of the association. It will be remembered that provisions for liquidated damages are sometimes referred to as maintenance clauses, on the well-founded theory that all members of a marketing agency should contribute to its maintenance and upkeep even though they may not make use of it for a particular period. In the Iowa case, the court held that the bylaw was unlawful as it was deemed to be in restraint of trade.

In the other cases cited with the Iowa case just discussed, the courts reached similar conclusions and for the same reason. Subsequent to the decision of the Iowa cases, a cooperative marketing act was enacted in that State which expressly authorized associations to provide for liquidated damages in their contracts and bylaws. Under this act the supreme court of that State held that a provision in the bylaws of a livestock association for the payment of 25 cents per 100 pounds for all livestock marketed by members outside the association was valid.<sup>91</sup> So that, so far as associations incorporated under the cooperative act of Iowa are concerned, they may provide for liquidated damages in their contracts or bylaws.

In Colorado, the rule announced by the supreme court, holding that provisions in contracts or bylaws which caused a member of an association to become liable to the association for a specified amount in the event he marketed his products outside the association were illegal, was changed by the supreme court in later cases in which the liquidated-damage clause provisions were authorized by cooperative acts under which the associations were formed.<sup>92</sup> The Alabama case referred to was decided by an intermediate court of that State and was superseded by a decision of the supreme court of the State.<sup>93</sup>

In many of the cooperative statutes, language is included which expressly authorizes associations to include in their contracts and bylaws provisions for liquidated damages. These provisions in the cooperative statutes specify

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*ville Milk Producers' Association v. Armstrong*, 178 N. Y. S. 612, 108 Misc. Rep. 582; *Castorland Milk & Cheese Co. v. Shantz*, 179 N. Y. S. 131; *Manchester Dairy System, Inc. v. Hayward*, 82 N. H. 193, 132 A. 12; *Potter v. Dark Tobacco Growers' Coop. Association*, 201 Ky. 441, 257 S. W. 33; *Elephant Butte Alfalfa Association v. Rouault*, 33 N. M. 136, 262 P. 185.

<sup>90</sup> *Reeves v. Decorah Farmers' Coop. Soc.*, 160 Iowa 194, 140 N. W. 844, 44 L. R. A. (N. S.) 1104; *Ludowese v. Farmers' Mut. Coop. Co.*, 164 Iowa 197, 145 N. W. 475; *Burns v. Wray Farmer's Grain Co.*, 65 Colo. 425, 176 P. 487, 11 A. L. R. 1179; *Atkinson v. Colorado Wheat Growers' Association*, 77 Colo. 559, 238 P. 1117; *Colorado Wheat Growers' Association v. Thede*, 80 Colo. 529, 253 P. 30; *Georgia Fruit Exchange v. Turnipseed*, 9 Ala. App. 123, 62 So. 542.

<sup>91</sup> *Clear Lake Coop. Live Stock Shippers' Association v. Weir*, 200 Iowa 1293, 206 N. W. 297.

<sup>92</sup> *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *Marvin v. Pueblo Dairymen's Cooperative*, 131 Colo. 601, 284 P. 2d 238, 12 A. L. R. 2d 130.

<sup>93</sup> *Ex parte Baldwin County Producers' Corporation*, 203 Ala. 345, 83 So. 69.

that the sums thus fixed shall be reasonable. The supreme courts of many States have passed upon the contracts of cooperatives formed under such statutes and have generally upheld the provisions contained in them with respect to liquidated damages. For instance, liquidated damages of 5 cents per pound in the case of tobacco,<sup>94</sup> 5 cents per pound for cotton,<sup>95</sup> 25 cents per bushel for wheat,<sup>96</sup> 50 cents per box for fruit,<sup>97</sup> and 5 cents per dozen for eggs<sup>98</sup> have all been upheld.

It should not be assumed from the foregoing that an association, even under a statute authorizing it to provide for liquidated damages, is free to fix any amount as such damages. On the contrary, the amount should always be reasonable and not so extravagantly large as to indicate that compensation to the association is not the object sought. The Supreme Court of Iowa has said, with reference to a provision purporting to provide for liquidated damages, that:

Where it appears that the amount provided for is disproportionate and excessive, equity will reject the terms of the proviso and declare a penalty.<sup>99</sup>

When the legal status of cooperatives was once established, it followed as a matter of course that such associations were entitled to provide for liquidated damages under circumstances comparable with those under which other entities might provide for and recover such damages, because liquidated damages were well known to the common law and are in no sense peculiar to cooperation. At the present time it is believed that cooperatives in each of the States may provide for liquidated damages, by reason of provisions existing in the statutory law of the State or by reason of the common law.

Some interesting cases involving liquidated damages have been before the courts. In a Kentucky case a member of the Dark Tobacco Growers' Cooperative Association rented his farm for cash rent, went to the city, and there worked as a carpenter. The association sued the landlord for liquidated damage of 5 cents per pound on account of the tobacco grown and sold by the tenant, who was not a member of the association and who marketed the tobacco through other channels. The contract of the landlord with the association covered all the tobacco grown on his land. The court held that the association was entitled to recover liquidated damages amounting to \$250, and referred to a provision in the Bingham Cooperative Act of Kentucky, which declares that it is a conclusive presumption that a member controls the products grown on his land.<sup>1</sup>

<sup>94</sup> *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231; *List v. Burley Tobacco Growers' Coop. Association*, 114 Ohio St. 361, 151 N. E. 471; *Dark Tobacco Growers' Coop. Association v. Mason*, 150 Tenn. 228, 263 S. W. 60; *Dark Tobacco Growers' Coop. Association v. Daniels*, 215 Ky. 67, 284 S. W. 399; *Dark Tobacco Growers' Coop. Association v. Robertson*, 84 Ind. App. 51, 150 N. E. 106.

<sup>95</sup> *South Carolina Cotton Growers' Coop. Association v. English*, 135 S. C. 19, 133 S. E. 542; *North Carolina Cotton Growers' Coop. Association v. Bullock*, 191 N. C. 464, 132 S. E. 154, 47 A. L. R. 924.

<sup>96</sup> *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311; *Nebraska Wheat Growers' Association v. Norquest*, 113 Neb. 731, 204 N. W. 798.

<sup>97</sup> *Lee v. Clearwater Growers' Association*, 93 Fla. 214, 111 So. 722; *Anaheim Citrus Fruit Association v. Yeoman*, 51 Cal. App. 759, 197 P. 959.

<sup>98</sup> *Poultry Producers of Central California v. Nilsson*, 197 Cal. 245, 239 P. 1086.

<sup>99</sup> *Fort Dodge Coop. Dairy Marketing Association v. Ainsworth*, 217 Iowa 712, 251 N. W. 85, 87. See also *Parker v. Dairymen's League Cooperative Association, Inc.*, 226 N. Y. S. 226, 222 App. Div. 341.

<sup>1</sup> *Dark Tobacco Growers' Coop. Association v. Daniels*, 215 Ky. 67, 284 S. W. 399.

Again it has been held that the inability of a member to deliver his products, because of a crop mortgage, does not prevent the association from recovering liquidated damages as a result of his failure to deliver.<sup>2</sup> And when a member of an association has signed a contract warranting that he was in position to control the wheat he produced, the fact that the president of the association told the member whose wheat was covered by a mortgage that he could deliver it to the mortgagee did not operate to relieve the member from liability to the association for liquidated damages on account of wheat so delivered.<sup>3</sup>

In the case last cited there were no exceptions in the contracts excusing failure to deliver because of the reasons therefor. Hence, the courts followed the general rule that impossibility of performance of a contract, unless created by an act of God, the law, or the complaining party, does not, as a rule, excuse failure to perform.<sup>4</sup> In other words, the members in the cases cited had agreed to deliver their products and, having failed to do so without a lawful excuse, they were liable for liquidated damages.

A rather novel case<sup>5</sup> arose involving the law of liquidated damages in California. The Civil Code of California stated that liquidated damages could be recovered by contract only where it is impracticable or extremely difficult to fix actual damages. However, the Agricultural Code of California authorized nonprofit marketing associations to fix by contract or bylaw liquidated damages to be paid on breach of contract with respect to sale, delivery, or withholding of products. About twenty raisin growers formed a cooperative under the laws of California. The association entered into a contract with a third person under which he was to receive and pack raisins upon delivery by members of the association. The marketing agreement between the association and its members provided for specified liquidated damages should the grower "fail to deliver raisins hereby sold in accordance with the terms of this agreement." One of these terms was to deliver raisins "properly cured and in good condition." Eight members of the cooperative, although delivering all the raisins they produced, delivered some raisins of such high moisture content that they could not be processed without redrying. Some of the other members of the cooperative brought an action against the members furnishing the wet raisins and against the association for the recovery of liquidated damages. A judgment in favor of the plaintiffs in the trial court was reversed on appeal. In denying recovery, the appellate court held that (1) the law did not authorize a contract for liquidated damages because of the delivery of inferior quality raisins but only for the failure to deliver the proper quantity, and (2) the marketing contract itself permitted recovery of liquidated damages only when a grower failed or refused to deliver all his raisins.

In California in cases in which it appeared that marketing contracts had been assigned to a cooperative, but in which it did not appear that the growers in question had become members of the association, it was held

<sup>2</sup> *North Carolina Cotton Growers' Coop. Association v. Bullock*, 191 N. C. 464, 132 S. E. 154, 47 A. L. R. 924; *Bishop v. Alabama Farm Bureau Cotton Association*, 215 Ala. 388, 110 So. 711; *Kansas Wheat Growers' Association v. Ast*, 118 Kan. 247, 234 P. 963; *Kansas Wheat Growers' Association v. Leslie*, 126 Kan. 694, 271 P. 284; *Lennox v. Texas Farm Bureau Cotton Association*, 16 S. W. 2d 413 (Tex. Civ. App.).

<sup>3</sup> *Kansas Wheat Growers' Association v. Leslie*, 126 Kan. 694, 271 P. 284.

<sup>4</sup> *Dermott v. Jones*, 2 Wall. 1, 69 U. S. 1, 17 L. Ed. 762, 76 U. S. 486, 19 L. Ed. 621.

<sup>5</sup> *Olson v. Biola Coop. Raisin Growers Association*, 184 P. 2d 742; affirmed, 193 P. 2d 929; 33 Cal. 2d 664, 204 P. 2d 10.



that provisions for liquidated damages in the marketing contracts were unenforceable.<sup>6</sup>

When a milk cooperative did not show that it was justified in rejecting milk tendered by a member, it could not recover liquidated damages for failure to deliver milk.<sup>7</sup>

Although a bylaw of an association provided that membership therein should cease in case any member failed to comply with the terms of his marketing contract, this did not prevent the association from recovering liquidated damages arising out of a breach of the marketing contract by a producer.<sup>8</sup>

In drafting a provision for liquidated damages, care should be taken that the rule prescribed for ascertaining the damages will be fair, equitable, and clear under all circumstances. For instance, a provision for the payment of \$10 per cow, in the event a member marketed any milk outside the association, has been criticized on the ground that it is uncertain whether the \$10 per cow is to be determined on a per-day basis or once and for all, or whether it would be applicable if a member marketed outside the association the milk from some cows but not from all.<sup>9</sup>

Cooperatives in entering into contracts with third persons, as well as with their members, should keep the foregoing principles in mind. In an Oregon case it was held that the stipulated damages specified in a contract entered into by a dairy cooperative with a dairy distributor amounted to a penalty.<sup>10</sup>

It has been held that the fact that a provision in a marketing agreement providing for liquidated damages is void because it does not conform to the statute under which the association is organized does not invalidate the entire contract.<sup>11</sup>

## Specific Performance

“SPECIFIC performance may be defined as the actual accomplishment of a contract by the party bound to fulfill it, for a decree for specific performance is nothing more or less than means of compelling a party to do precisely what he ought to have done without being coerced by a court.”<sup>12</sup>

It should be borne in mind that the term “specific performance” is the name of an equitable remedy, by means of which a person is affirmatively compelled by the court to perform his contract. It is true that growers are frequently enjoined from disposing of their products outside the association of which they are members, in violation of their contracts; and this, generally speaking, results in the contract actually being performed; but, strictly speaking, this is not what is meant by the term “specific performance.” The cooperative statutes that have been enacted by the

<sup>6</sup> *Sun-Maid Raisin Growers of California v. Paul A. Mosesian & Son, Inc.*, 90 Cal. App. 1, 265 P. 828; *Sun-Maid Raisin Growers of California v. K. Arakelian, Inc.*, 90 Cal. App. 10, 265 P. 832.

<sup>7</sup> *Frame v. Trenton Milk & Cream Company, Inc.*, 210 N. Y. S. 591, 125 Misc. Rep. 86.

<sup>8</sup> *Milk Producers' Association v. Webb*, 97 Cal. App. 650, 275 P. 1001.

<sup>9</sup> *Pierce County Dairymen's Association v. Templin*, 124 Wash. 567, 215 P. 352. See also *Watertown Milk Producers' Coop. Association v. Van Camp Packing Co.*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391.

<sup>10</sup> *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 147 Ore. 503, 30 P. 2d 344.

<sup>11</sup> *Watertown Milk Producers' Coop. Association v. Van Camp Packing Company*, 199 Wis. 379, 225 N. W. 209, 226 N. W. 378, 77 A. L. R. 391.

<sup>12</sup> 25 R. C. L. 203.

States usually contain a provision stating that an association shall be entitled, in the event of a breach or threatened breach of its marketing contract, "to an injunction to prevent the further breach of the contract and to a decree of specific performance thereof."<sup>13</sup>

Many cases have been before the courts, involving the right of cooperatives to the remedies of specific performance and injunction on account of the statutory provision in question. In Kansas it was held that the statutory provision was virtually mandatory on the court, at least under normal conditions, and that the legislature was competent to enact a rule of this kind which was binding on the courts.<sup>14</sup> In States other than Kansas substantially similar conclusions have been reached in cases involving the right of associations to the remedies of injunction and specific performance under the statutory provision in question.<sup>15</sup>

In many cases brought by cooperatives against their members to prevent them from violating their contracts, the association in question has asked the court to enjoin the member from disposing of his products to third persons, without asking the court to decree the specific performance of the contract involved. Some of these cases are discussed under the heading "Injunctions."

Independent of a statutory provision entitling a cooperative to the remedy of specific performance, will courts of equity thus compel members of cooperatives to perform their contracts? The fundamental rule with respect to this matter is that no one is entitled to a decree for specific performance, an injunction, or other equitable relief where the remedy at law is plain, adequate, and complete. In general, courts of equity will refuse to grant a decree for specific performance or an injunction if compensation in money for the breach of the contract would constitute full and complete satisfaction. In the case of contracts involving personal property which can be easily purchased in the open market, usually no decree for specific performance will be granted. When a cooperative is restricted by the statute under which it is formed, by its charter, or by its contract, to dealing only with its members, it cannot legally buy products to take the place of those which its members refused to deliver, and this fact has been referred to in some instances by the courts as constituting a reason why an association was entitled to have its contract with a member performed.<sup>16</sup>

Even though there is no provision in the law of a State specifically entitling an association to the remedies of specific performance and injunction against

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<sup>13</sup> See par. (b) of sec. 18 of the Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>14</sup> *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311.

<sup>15</sup> *Lee v. Clearwater Growers' Association*, 93 Fla. 214, 111 So. 722; *Texas Farm Bureau Cotton Association v. Stovall*, 113 Tex. 273, 253 S. W. 1101, reversing 248 S. W. 1109 (Tex. Civ. App.); *South Carolina Cotton Growers' Coop. Association v. English*, 135 S. C. 19, 133 S. E. 542; *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *Arkansas Cotton Growers' Coop. Association v. Brown*, 168 Ark. 504, 270 S. W. 946; *McCauley v. Arkansas Rice Growers' Coop. Association*, 171 Ark. 1155, 287 S. W. 419; *Warren v. Alabama Farm Bureau Cotton Association*, 213 Ala. 61, 104 So. 264; *Harrell v. Cane Growers' Coop. Association*, 160 Ga. 30, 126 S. E. 531; *Colma Vegetable Association v. Bonetti*, 91 Cal. App. 103, 267 P. 172; *Nebraska Wheat Growers' Association v. Smith*, 115 Neb. 177, 212 N. W. 39; *Brown v. Staple Cotton Coop. Association*, 132 Miss. 859, 96 So. 849.

<sup>16</sup> *Oregon Growers' Coop. Association v. Lentz*, 107 Ore. 561, 212 P. 811; *Bishop v. Alabama Farm Bureau Cotton Association*, 215 Ala. 388, 110 So. 711; *Manchester Dairy System, Inc. v. Hayward*, 82 N. H. 193, 132 A. 12; *Dark Tobacco Growers' Coop. Association v. Dunn*, 150 Tenn. 614, 266 S. W. 308; *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311.

its members, the courts in some instances have held that associations were entitled to both these remedies.<sup>17</sup>

Although most of the cases that have come before the courts involving the right of an association to the remedy of injunction or specific performance, or both, have involved the purchase-and-sale form of contract, the courts have enforced agency contracts by these remedies.<sup>18</sup>

Associations formed in one State have frequently been held entitled to the remedies of injunction and specific performance in suits brought in other States.<sup>19</sup>

Outside the field of cooperation, the courts have upheld the right of commercial concerns to the remedies of specific performance and injunction with respect to oil,<sup>20</sup> tomatoes,<sup>21</sup> and pineapples,<sup>22</sup> when it appeared that the products named could not be easily obtained in the open market. Some courts will refuse to decree the specific performance of a contract while enjoining the delinquent party from disposing of the products involved to third persons. Thus, the Supreme Court of Washington, independent of statute, in a cooperative case refused under the general principles of equity to decree the specific performance of the contract on the ground that it would call for constant supervision, but enjoined the member from disposing of his cranberries outside the association.<sup>23</sup> A similar conclusion was reached by the Supreme Court of Oregon.<sup>24</sup>

## Injunctions

“AN INJUNCTION is an order issued by a court of equity, requiring a party to do or refrain from doing certain acts.”<sup>25</sup> Injunctions are usually issued to prevent a threatened injury or to restrain the doing of wrongful acts. In general it appears settled that cooperatives are entitled to enjoin their members from disposing of their products to third persons in violation of their contracts. Many of the cooperative statutes contain a provision entitling associations formed under them to the remedy of injunction against their members to prevent the violation by them of their contracts. A number of cases are cited in the preceding section which are directly applicable here. Other cases are here cited in which associations enjoined their members without asking the court to decree the specific performance of the contract involved.<sup>26</sup> Independent of statute,

<sup>17</sup> *Elephant Butte Alfalfa Association v. Rouault*, 33 N. M. 136, 262 P. 185; *Manchester Dairy System, Inc. v. Hayward*, 82 N. H. 193, 132 A. 12.

<sup>18</sup> *Elephant Butte Alfalfa Association v. Rouault*, 33 N. M. 136, 262 P. 185; *Elmore v. Maryland & Virginia Milk Producers' Association, Inc.*, 145 Va. 42, 132 S. E. 521, 134 S. E. 472.

<sup>19</sup> *Dark Tobacco Growers' Coop. Association v. Dunn*, 150 Tenn. 614, 266 S. W. 308; *Brown v. Staple Cotton Coop. Association*, 132 Miss. 859, 96 So. 849; *Elephant Butte Alfalfa Association v. Rouault*, 33 N. M. 136, 262 P. 185; *Manchester Dairy System, Inc. v. Hayward*, 82 N. H. 193, 132 A. 12; *Nebraska Wheat Growers' Association v. Norquest*, 113 Neb. 731, 204 N. W. 798.

<sup>20</sup> *Texas Co. v. Central Fuel Oil Co.*, 194 F. 1. See also *American Smelting & Refining Co. v. Bunker Hill & Sullivan Mining Co.*, 248 F. 172.

<sup>21</sup> *Curtice Bros. Co. v. Catts*, 72 N. J. Eq. 831, 66 A. 935.

<sup>22</sup> *Hawaiian Pineapple Co., Ltd. v. Saito*, 270 F. 749.

<sup>23</sup> *Washington Cranberry Growers' Association v. Moore*, 117 Wash. 430, 201 P. 773, 204 P. 811, 25 A. L. R. 1077.

<sup>24</sup> *Phéz Co. v. Salem Fruit Union*, 103 Ore. 514, 201 P. 222, 205 P.-970, 25 A. L. R. 1090.

<sup>25</sup> 22 Cyc. 740.

<sup>26</sup> *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231; *Tobacco Growers' Coop. Association v. Spikes*, 187 N. C. 367, 121 S. E. 636; *Tobacco Growers' Coop. Association v. Battle*, 187 N. C. 260, 121 S. E.



the courts have held in a number of instances that cooperatives were entitled to enjoin their members from disposing of their products outside the association.<sup>27</sup>

In a few cases involving extraordinary situations, the courts have denied associations the remedies of specific performance and injunction. In an Alabama case<sup>28</sup> the court said that the statutory provisions relative to the equitable remedies under discussion were to "be construed as contemplating the use of such remedies only in case they shall be found to consist with commonly accepted principles of right and justice," and the court, therefore, completely denied the association the remedies in question because of a mortgage held by a third person on the crop.

In a similar case arising in North Carolina<sup>29</sup> the court enjoined the member from disposing of his crop outside the association, subject to the right of a holder of the mortgage on the crop to demand and receive enough tobacco to satisfy the mortgage.

In another North Carolina case<sup>30</sup> the court refused an injunction because the association had not settled with the member in full for a crop previously delivered and it appeared that the member was obliged "to raise money for the necessary supplies of himself and family." In refusing the injunction the court called attention to the rule that under the general principles of equity "an injunction will not usually be granted or continued where 'it will do more mischief and work greater injury than the wrong which it is asked to redress'."

In a Florida case in which an injunction was denied the Chancellor found that—

the price of milk allowed and paid by plaintiff to the defendant is below the cost of production as shown by the testimony and that defendant was justified under the circumstances in withdrawing from the plaintiff association, to avoid irreparable loss and injury, and virtual confiscation of her property.

The supreme court of the State affirmed the lower court but held that

629; *Tobacco Growers' Coop. Association v. Patterson*, 187 N. C. 252, 121 S. E. 631; *Potter v. Dark Tobacco Growers' Coop. Association*, 201 Ky. 441, 257 S. W. 33; *Burley Tobacco Growers' Coop. Association v. Devine*, 217 Ky. 320, 289 S. W. 253; *Elmore v. Maryland & Virginia Milk Producers' Association, Inc.*, 145 Va. 42, 132 S. E. 521, 134 S. E. 472; *Washington Wheat Growers' Association v. Leifer*, 132 Wash. 602, 232 P. 339; *Northwest Hay Association v. Hanson*, 135 Wash. 47, 236 P. 561; *Pierce County Dairymen's Association v. Templin*, 124 Wash. 567, 215 P. 352; *Washington Coop. Egg & Poultry Association v. Taylor*, 122 Wash. 466, 210 P. 806; *Minnesota Wheat Growers' Coop. Marketing Association v. Huggins*, 162 Minn. 471, 203 N. W. 420; *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *Nebraska Wheat Growers' Association v. Norquest*, 113 Neb. 731, 204 N. W. 798; *Kansas Wheat Growers' Association v. Charlet*, 118 Kan. 765, 236 P. 657; *Beaulaurier v. Washington State Hop Producers, Inc.*, 8 Wash. 2d 79, 111 P. 2d 559.

<sup>27</sup> *Oregon Growers' Coop. Association v. Lentz*, 107 Ore. 561, 212 P. 811; *Phez Co. v. Salem Fruit Union*, 103 Ore. 514, 201 P. 222, 205 P. 970, 25 A. L. R. 1090; *Washington Cranberry Growers' Association v. Moore*, 117 Wash. 430, 201 P. 773, 204 P. 811, 25 A. L. R. 1077; *Grant County Board of Control v. Alphin*, 152 Ky. 280, 153 S. W. 417; *Owen County Burley Tobacco Society v. Brumback*, 128 Ky. 137, 107 S. W. 710; *Elephant Butte Alfalfa Association v. Rouault*, 33 N. M. 136, 262 P. 185; *Manchester Dairy System, Inc. v. Hayward*, 82 N. H. 193, 132 A. 12; *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231.

<sup>28</sup> *Bishop v. Alabama Farm Bureau Cotton Association*, 215 Ala. 388, 110 So. 711, 712. See also *Lennox v. Texas Farm Bureau Cotton Association*, 16 S. W. 2d 413 (Tex. Civ. App.).

<sup>29</sup> *Tobacco Growers' Coop. Association v. Patterson*, 187 N. C. 252, 121 S. E. 631. See also *Tobacco Growers' Coop. Association v. Harvey & Son Co.*, 189 N. C. 494, 127 S. E. 545, 47 A. L. R. 928.

<sup>30</sup> *Tobacco Growers' Coop. Association v. Bland*, 187 N. C. 356, 121 S. E. 636, 638, 639.

this would not operate to prevent the association from recovering damages.<sup>31</sup>

In a Colorado case,<sup>32</sup> injunction was held unwarranted where the marketing agreement provided for liquidated damages, the dairyman was not bound for a specified time, and he had exercised his right to quit in compliance with the terms of the agreement. The dairyman was allowed to recover on a counterclaim for damages suffered while the temporary restraining order and injunction were in effect, less the amount of liquidated damages due the association.

In a Tennessee case<sup>33</sup> in which the members of the association concerned were not made parties and in which it was not alleged that the third persons who had purchased milk of the members were insolvent, the court refused to enjoin them from buying milk of the members. The court apparently believed that, as the statute under which the association was incorporated specifically authorized associations formed thereunder to enjoin their members from violating their marketing contracts, this operated adversely against an association in seeking an injunction solely against third persons. However, in a Wisconsin case a livestock shipping association was granted an injunction against a third party who had purchased livestock from one of its members, enjoining him from making any further purchases from association members.<sup>34</sup> The statute provided for injunctive relief in such a situation and the court regarded the statute as mandatory.

An injunction will not be granted to restrain producers from violating their marketing agreements if the producers cancel the contracts while the suit is pending.<sup>35</sup>

In Tennessee, Kansas, and Kentucky, the courts have required members of associations to deliver their products thereto (although the holders of mortgages on the crops protested) where it appeared that the holders of the mortgages took them with notice that the members were under contract to deliver their products to the association for marketing.<sup>36</sup>

In a Nebraska case alleged mismanagement of the association was held to be no defense to a suit for an injunction.<sup>37</sup> Where a member of a milk cooperative agreed that he would not market milk "for less than the price agreed upon and fixed by the association as the minimum price," it was held that the association was entitled to an injunction to prevent the member from selling milk below such minimum price and that the member could not raise a question as to the constitutionality of the statute under which the association was incorporated, or with respect to the terms of the contract entered into by him with the association.<sup>38</sup>

Under normal circumstances, the statutory provisions under discussion would appear to be virtually mandatory on the court concerned.

<sup>31</sup> *Miami Home Milk Producers' Association v. La Course*, 117 Fla. 345, 158 So. 117, 118.

<sup>32</sup> *Marvin v. Pueblo Dairymen's Cooperative*, 131 Colo. 601, 284 P. 2d 238, 12 A. L. R. 2d 130.

<sup>33</sup> *Knoxville Milk Producers' Association v. Blake*, 171 Tenn. 283, 102 S. W. 2d 64.

<sup>34</sup> *Neillsville Shipping Association v. Lastofka*, 225 Wis. 350, 274 N. W. 280.

<sup>35</sup> *Pure Milk Producers' Association of Greater Kansas City Territory v. Bridges*, 146 Kan. 15, 68 P. 2d 658.

<sup>36</sup> *Dark Tobacco Growers' Coop. Association v. Dunn*, 150 Tenn. 614, 266 S. W. 308; *Kansas Wheat Growers' Association v. Floyd*, and *Kansas Wheat Growers' Association v. Robben*, 116 Kan. 522, 227 P. 336; *Redford v. Burley Tobacco Growers' Coop. Association*, 205 Ky. 515, 266 S. W. 24.

<sup>37</sup> *Nebraska Wheat Growers' Association v. Smith*, 115 Neb. 177, 212 N. W. 39.

<sup>38</sup> *Johnson v. Georgia-Carolina Retail Milk Producers Association*, 182 Ga. 695, 186 S. E. 824. See also *Olympia Milk Producers' Association v. Herman*, 176 Wash. 338, 29 P. 2d 676; *Owen County Burley Tobacco Society v. Brumback*, 128 Ky. 137, 107 S. W. 710.

Prior to 1923 the Supreme Court of California refused to enjoin a producer from disposing of eggs outside the association because of a code provision which forbade the issuance of injunctions to restrain the violation of contracts that could not be enforced specifically.<sup>39</sup> A statute was enacted in California in 1923 specifically giving cooperatives the right to the equitable remedies in question.<sup>40</sup> The courts of California have always upheld the right of cooperatives to recover liquidated damages.<sup>41</sup>

The courts have frequently pointed out the reasons why a judgment in favor of an association for a definite amount of money would not adequately compensate it for the loss suffered through the failure of a member to deliver his products.<sup>42</sup> In the case last cited the court said:

Judgment for the loss of the profits which would have accrued to the association solely from the resale of the products withheld by a breaching member would not necessarily measure the damages to the association. If one member may breach his contract with impunity, so might others. With each withdrawal a larger proportionate share of the expenses would fall upon the remaining members. It would be impossible to compute the losses which would thus progressively accrue to the association and its remaining members; nor would this diminution of the proportionate returns, if they could be computed, measure the full extent of the wrong to the association. The influence of the conduct of the breaching member would inevitably tend to promote further withdrawals and impair the ability of the association to secure new members. If indulged in by a sufficient number, it would impair the effective existence of the association, if, in fact, it did not bring about a dissolution. It is plain that an unrestrained breach of member contracts would produce irreparable injury to the association, and, through it, to each of the remaining members.

Owing to the need for prompt action, courts that exercise equity powers generally may issue a restraining order without prior notice to the defendant, upon the submission of a verified complaint, on its face showing applicant entitled thereto. On the issuance of a restraining order a copy of the complaint and order are served on the defendant, and he is notified of a date, usually an early one, on which he may show cause why he should not be enjoined. As a defendant or grower is usually enjoined before he has had an opportunity to be heard, an association, under the recent cooperative statutes,<sup>43</sup> and under the laws and principles generally applicable, must execute a bond to protect the grower in the event it should develop, on the hearing, that a restraining order should not have been issued.

Although the cooperative marketing act of a State specifically authorized an association that is incorporated thereunder to obtain an injunction to prevent the breach of its marketing agreement, it was held that an association must proceed in accordance with a subsequently enacted general injunction act in seeking an injunction.<sup>44</sup>

In a Mississippi case<sup>45</sup> an association was held liable on its bond to the extent of \$100, the amount thereof, because of the erroneous procurement by the association of an injunction.

<sup>39</sup> *Poultry Producers of Southern California, Inc., v. Barlow*, 189 Cal. 278, 208 P. 83; *Poultry Producers of Central California, Inc. v. Murphy*, 64 Cal. App. 450, 221 P. 962; *Poultry Producers of Central California v. Nilsson*, 197 Cal. 245, 239 P. 1086.

<sup>40</sup> *Colma Vegetable Association v. Bonetti*, 91 Cal. App. 103, 267 P. 172.

<sup>41</sup> See cases cited in two preceding footnotes.

<sup>42</sup> *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311; *Dark Tobacco Growers' Coop. Association v. Dunn*, 150 Tenn. 614, 266 S. W. 308; *Manchester Dairy System, Inc. v. Hayward*, 82 N. H. 193, 132 A. 12, 16.

<sup>43</sup> See par. (b) of sec. 18 of the Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>44</sup> *Rapides Dairy Dealers' Cooperative Association v. Mathews*, 158 So. 247 (La. App.).

<sup>45</sup> *Staple Cotton Coop. Association v. Borodofsky*, 143 Miss. 558, 108 So. 802. See also *Garden Plain Farmers' Elevator Co. v. Kansas Wheat Growers' Association*, 128 Kan. 218, 276 P. 799.



In a Kentucky case <sup>46</sup> the restraining order issued by the court was dissolved on the final hearing. In the meantime the tobacco had been stolen. Suit was then brought on the bond, but the court found that the theft of the tobacco was not the natural and proximate result of the issuance of the restraining order and consequently held that there could be no recovery on the bond.

A cooperative may be enjoined in a proper case. When it was found that a father who was a member of a dairy association had in good faith transferred his cows to his son, who was not a member, it was held that the son was entitled to an injunction against the association to prevent it from interfering with the marketing of the milk from the cows.<sup>47</sup> Where a cooperative acted in good faith, had discontinued the practices complained of, and the complaint was based on facts which it had voluntarily disclosed, it was not enjoined from violation of Office of Economic Stabilization regulations.<sup>48</sup>

A milk association was enjoined from interfering with the business of a milk distributor by circulating false statements with respect to his business and from "seeking to induce persons dealing with said defendant to sever or discontinue their business relations with said defendant, for the purpose of injuring the said defendant in the profitable conduct of his business," but on appeal it was held that this did not prevent the association from engaging in organizational work, if this were not done for the purpose of injuring the milk distributor in the profitable conduct of his business. In other words, the purpose for which producers might be solicited to become members of the association would determine the legality of such action.<sup>49</sup>

In accordance with equitable principles and without specific statutory authority therefor, an Oregon dairy cooperative enjoined a dairy distributor which had contracted to buy all the milk it needed from the association from purchasing dairy products from others; and the fact that a new corporation had been formed for the purpose of avoiding the terms of the contract entered into by a predecessor corporation with the association was held to be immaterial.<sup>50</sup>

In two cases <sup>51</sup> nonprofit associations of dairymen were not successful in enjoining the enforcement of certain local city ordinances regulating the marketing of milk. In the first case cited the regulation was held valid and in the second case an injunction was denied on the grounds that an adequate remedy at law existed.

A cooperative, like any other business concern, may by injunction protect its trade-marks from unauthorized use.<sup>52</sup>

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<sup>46</sup> *Burley Tobacco Growers' Coop. Association v. Pennebaker Home for Girls*, 221 Ky. 718, 299 S. W. 734.

<sup>47</sup> *Wesemann v. Watertown Milk Coop. Association*, 222 Wis. 475, 269 N. W. 246.

<sup>48</sup> *Bowles v. Floodwood Cooperative Creamery Association*, 62 F. Supp. 709.

<sup>49</sup> *Pure Milk Producers' Association of Greater Kansas City Territory v. Bridges*, 146 Kan. 15, 68 P. 2d 658.

<sup>50</sup> *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 147 Ore. 503, 30 P. 2d 344.

<sup>51</sup> *Independent Dairymen's Association, Inc. v. City and County of Denver*, 142 F. 2d 415; *Farmers' Dairy League, Inc. v. City and County of Denver*, 112 Colo. 399, 149 P. 2d 370. Cf. *Minor v. City of Keokuk, Iowa*, 92 F. Supp. 833; *Moultrie Milk Shed, Inc. v. City of Cairo*, 206 Ga. 348, 57 S. E. 2d 199.

<sup>52</sup> *California Fruit Growers Exchange v. Sunkist Drinks, Inc.*, 25 F. Supp. 401; *California Fruit Growers Exchange v. Windsor Beverages*, 118 F. 2d 149; *California Fruit Growers Exchange v. Gonska*, 55 F. Supp. 499; *California Fruit Growers' Exchange v. Sunkist Baking Co.*, 68 F. Supp. 946; *California Prune & Apricot Growers Association v. H. R. Nicholson Co.*, 69 Cal. App. 2d 207, 158 P. 2d 764; *Fruit Growers Coop. v. M. W. Miller & Co.*, 73 F. Supp. 90; *Hi-Land Dairymen's Association v. Cloverleaf Dairy*, 107 Utah 67, 151 P. 2d 710.

In an Oklahoma case a creamery company failed to give a milk association security to insure the payment for milk and milk products delivered thereto by the association, which the association was authorized to require the company to give. The association then terminated the contract with the company in accordance with its terms. Thereupon the association sought to enjoin the company from buying milk of others. It was held that the association was not entitled to an injunction, as this would have destroyed the company's business and would only have aided the association by destroying the outlet for the milk of competitive milk producers who were not members of the association. The court said that the power of injunction "should not be used merely to punish for a violation of the terms of a contract."<sup>53</sup>

It has been held that because farmers were not members of a rural electric membership corporation they were not entitled to restrain the corporation from consummating an agreement with a power company covering the furnishing of electricity.<sup>54</sup>

The terms of an injunction order should not be broader than the obligation of the member.<sup>55</sup> In a Texas case<sup>56</sup> it was recognized that a grower might be entitled to damages from a cotton association if the association had enjoined the grower from selling cotton that was not covered by the marketing contract of the association.

A failure to comply with an injunction order or a decree for the specific performance of a contract causes the person concerned to be in contempt of court, for which he may be fined or sent to jail. An officer of a cooperative may be in contempt of court for failing to observe an injunction order issued against his association, of which he has notice, but with which he has not been served.<sup>57</sup> It is the authority of a court to fine a defendant or send him to jail that gives force to its orders.

## Interference With Marketing Contracts

**W**HAT may cooperatives do to prevent third persons from causing their members to breach their contracts?

Independent of statute, it has been repeatedly held that, if one maliciously interferes in a contract between two parties and induces one of them to break that contract to the injury of the other, the party injured can maintain an action against the wrongdoer for damages.<sup>58</sup> A milk bargaining association was allowed to recover damages from a company found to be interfering with its contracts and apparently also was granted an injunction against such interference.<sup>59</sup> The company was not required, however, to

<sup>53</sup> *Tulsa Creamery Company v. Tulsa Milk Products Cooperative Association*, 175 Okla. 51, 51 P. 2d 950, 951.

<sup>54</sup> *Bailey v. Carolina Power & Light Company*, 212 N. C. 768, 195 S. E. 64.

<sup>55</sup> *Pierce County Dairymen's Association v. Templin*, 124 Wash. 567, 215 P. 352.

<sup>56</sup> *Lennox v. Texas Cotton Coop. Association*, 55 S. W. 2d 543 (Tex. Com. App.).

<sup>57</sup> *Mattos v. Superior Court*, 30 Cal. App. 2d 641, 86 P. 2d 1056; *Pure Milk Association v. Wagner*, 363 Ill. 316, 2 N. E. 2d 288.

<sup>58</sup> *Monte Vista Potato Growers' Coop. Association v. Bond*, 80 Colo. 516, 252 P. 813; *Angle v. Chicago, St. Paul, Minneapolis and Omaha Railway Co.*, 151 U. S. 1, 14 S. Ct. 240, 38 L. Ed. 55; *Knickerbocker Ice Co. v. Gardiner Dairy Co.*, 107 Md. 556, 69 A. 405, 16 L. R. A. (N. S.) 746; *Wheeler-Stenzel Co. v. American Window Glass Co.*, 202 Mass. 471, 89 N. E. 28, L. R. A. 1915F 1076; *Aalfo Co., Inc., v. Kinney*, 105 N. J. Law 345, 144 A. 715.

<sup>59</sup> *Pure Milk Association v. Kraft Foods Co.*, 8 Ill. App. 2d 102, 130 N. E. 2d 765. See *When Title to Products Passes to the Association*, p. 105; *Pacific Wool Growers v. Draper & Co.*, 158 Ore. 1, 73 P. 2d 1391; *California Grape Control Board, Ltd. v. California Produce Corporation*, 4 Cal. 2d 242, 40 P. 2d 846; *Knoxville Milk Producers' Association v. Blake*, 171 Tenn. 283, 102 S. W. 2d 64.

comply with an attempted partial assignment of sales proceeds (dues of three cents per hundredweight) contained in the marketing contract, since this "check-off" clause was considered too burdensome on the company.

The court enjoined a trucking company, in a Rhode Island case,<sup>60</sup> from delivering the milk of its members residing in Connecticut, except as prescribed by the association.

In a Wisconsin case,<sup>61</sup> in which a cooperative enjoined a dealer in tobacco who actively and intentionally tried to induce members of the association to breach their contracts, the supreme court of that State said: "We consider the law well settled that one who maliciously induces another to breach a contract with a third person is liable to such third person for the damages resulting from such breach."

In a later case,<sup>62</sup> a livestock shipping association was granted an injunction against a third person who had purchased livestock from one of its members enjoining him from making any further purchases from association members. The association also was allowed to recover the actual damages sustained because the livestock was not marketed through the association.

In a Texas case<sup>63</sup> and in a North Carolina case<sup>64</sup> suits were brought by each association involved against members and dealers who were handling or offering to handle its products with knowledge of the fact that the products were covered by contracts with the association, and in each of these cases the members were enjoined from disposing of their products outside the association and the dealers were enjoined from interfering with the performance of the contracts. The cooperative cases cited above were all decided under the general principles of equity and independent of statutory provisions.

In an Iowa case,<sup>65</sup> it was held that a cooperative had stated a cause of action for an injunction against a third person for engaging in allegedly unfair trade practices with intent to injure the cooperative even though the State statute made the acts complained of criminal offenses.

In addition, many of the statutes providing for the formation of cooperatives make it a misdemeanor knowingly to induce the breach of a marketing contract and authorize associations to recover a penalty of \$500 for each such offense. They authorize also the recovery of a similar penalty for knowingly spreading reports about the management or finances of an association.<sup>66</sup>

In a New York case an association failed to recover the statutory penalty because apparently the court was of the opinion that the reports that were

<sup>60</sup> *Local Dairymen's Cooperative Association v. Potvin*, 54 R. I. 430, 173 A. 535. See also *Northern Wisconsin Coop. Tobacco Pool v. Bekkedal*, 182 Wis. 571, 197 N. W. 936; *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 147 Ore. 503, 30 P. 2d 344.

<sup>61</sup> *Northern Wisconsin Coop. Tobacco Pool v. Bekkedal*, 182 Wis. 571, 197 N. W. 936, 939. See also *Phez Co. v. Salem Fruit Union*, 103 Ore. 514, 201 P. 222, 205 P. 970, 25 A. L. R. 1090; *Monte Vista Potato Growers' Coop. Association v. Bond*, 80 Colo. 516, 252 P. 813; *Wilson v. Monte Vista Potato Growers' Coop. Association*, 82 Colo. 428, 260 P. 1080.

<sup>62</sup> *Neillsville Shipping Association v. Lastofka*, 225 Wis. 350, 274 N. W. 280.

<sup>63</sup> *Hollingsworth v. Texas Hay Association*, 246 S. W. 1068 (Tex. Civ. App.).

<sup>64</sup> *Tobacco Growers' Coop. Association v. Pollock*, 187 N. C. 409, 121 S. E. 763.

<sup>65</sup> *Farmers Cooperative Association v. Quaker Oats Co.*, 233 Iowa 701, 7 N. W. 2d 906.

<sup>66</sup> See secs. 26 and 27 of the Bingham Cooperative Marketing Act of Kentucky, p. 307 of Appendix.



alleged to be false were of a creditable nature, or were not false within the meaning of the statute.<sup>67</sup>

Sections 26 and 27 of the Bingham Cooperative Marketing Act of Kentucky were upheld by the Supreme Court of the United States in a case arising in Kentucky,<sup>68</sup> in which the Burley Tobacco Growers' Cooperative Association recovered a penalty of \$500 from a warehouse company that sold tobacco that was covered by a marketing contract of the association. "Before the sale the association notified the warehouse company of Kielman's membership and of his marketing contract, requested it not to sell his tobacco, and called attention to the prescribed penalties." Similar provisions in the cooperative acts of Colorado<sup>69</sup> and Virginia<sup>70</sup> were upheld in those States.

In an Arkansas case<sup>71</sup> it was held that before an association could recover the statutory penalty from a person who had purchased commodities from one of its members that were covered by its marketing contract, the association must show that the purchaser had actually induced the member to sell them.

The Supreme Court of Minnesota held that a similar penalty section in one of the cooperative statutes of that State was unconstitutional because it violated the freedom-of-contract provisions in the State and Federal Constitutions.<sup>72</sup> In reaching this conclusion, the court said:

Of course, it is well settled that a malicious interference by one not a party to a contract to induce its breach is a tort for which redress may be had. \* \* \* But section 27 does not stop with those who maliciously interfere with existing contracts between third parties. \* \* \* In other words, the section attempts to prevent all dealings between members of a cooperative marketing association and outsiders in respect to products contracted for by the association, no matter how free from legal malice or devoid of inducements the conduct of the outsiders may have been, provided they knew that the product was under contract.

In a Colorado case<sup>73</sup> a competitor of a cooperative inserted advertisements in a local paper relative to the decline in the price of cabbage. As the statements in these advertisements apparently were considered to be simply an honest expression of opinion, it was held that they did not violate an injunction order which, among other things, forbade interference with "any of the business of the exchange." In other words, the court held that the injunction order quoted was too broad or that it should be confined to instances of illegal interference. In an Oregon case,<sup>74</sup> in which the members of a cooperative had disabled the association from fulfilling a contract which it had made with a buyer of loganberries by failing or refusing to deliver their loganberries to the association for marketing, the court held that the buyer had a cause of action against the association and

<sup>67</sup> *Dairymen's League Coop. Association, Inc. v. Brockway Company*, 18 N. Y. S. 2d 551, 173 Misc. 183.

<sup>68</sup> *Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Association*, 276 U. S. 71, 48 S. Ct. 291, 72 L. Ed. 473, affirming 208 Ky. 643, 271 S. W. 695.

<sup>69</sup> *Fort v. People ex rel. Coop. Farmers' Exchange*, 81 Colo. 420, 256 P. 325; *Rinnander v. Denver Milk Producers, Inc.*, 114 Colo. 506, 166 P. 2d 984.

<sup>70</sup> *Tobacco Growers' Coop. Association v. Danville Warehouse Co., Inc.*, 144 Va. 456, 132 S. E. 482.

<sup>71</sup> *Loewer v. Arkansas Rice Growers' Cooperative Association*, 180 Ark. 484, 22 S. W. 2d 17.

<sup>72</sup> *Minnesota Wheat Growers' Coop. Marketing Association v. Radke, and v. Commander Elevator Co.*, 163 Minn. 403, 204 N. W. 314, 315. See also *Schwartz v. Rice County Cooperative Egg and Poultry Association*, 163 Minn. 515, 204 N. W. 316.

<sup>73</sup> *Fort v. People ex rel. Coop. Farmers' Exchange*, 81 Colo. 420, 256 P. 325. See also *Western Seed Co. v. Cooperative Farmers' Exchange*, 81 Colo. 448, 256 P. 329.

<sup>74</sup> *Phez Co. v. Salem Fruit Union*, 103 Ore. 514, 201 P. 222, 205 P. 970, 25 A. L. R. 1090.

against the members, because they had prevented the association from performing its contract.

Virginia<sup>75</sup> and Kentucky<sup>76</sup> have enacted statutes, sometimes referred to as "True Name Laws," that require warehousemen to keep records showing the true names of the owners of tobacco they have for sale, and permitting the inspection of such records. It was claimed by opponents of this legislation that the purpose of the statutes was to enable cooperatives to ascertain if their members were disposing of tobacco to others. These statutes have been upheld.<sup>77</sup>

In a number of States provision is made for the filing of record of marketing contracts for the purpose of giving constructive notice of the rights of the associations.<sup>78</sup> Although a defendant in one case<sup>79</sup> sought to avoid an injunction on the ground that the marketing contract in question had not been properly filed and indexed as required by law, the court found it unnecessary to consider this question. It said that the proven facts were such as to have put the defendant on actual notice of the contract.

It should be kept in mind that a cooperative may not unlawfully interfere with the right of third persons to contract even though it is simply attempting to advance its interests.<sup>80</sup> A legitimate end does not justify illegal means.

## Transfers in Attempts To Avoid Contracts

ATTEMPTS have been made by members of cooperatives to "transfer" their farms and thus avoid their marketing contracts by conducting their farming operations in the names of their wives or other persons. The courts have repeatedly declared that marketing contracts may not be avoided in this way. The real test in cases of this character depends upon whether the transfer involved was one in fact, or one in form only.

In other words, was the transfer simply a colorable transaction or a transfer in good faith? If subsequent to the alleged transfer, the farming operations were conducted in substantially the same manner as they were before the transfer, then the courts hold the transfer ineffective,<sup>81</sup> and the crops grown are subject to the marketing contract. On the other hand, if the farming operations subsequent to the transfer are in fact conducted by the wife of a member, as was done in a Virginia case, in which the wife leased a

<sup>75</sup> Code of Virginia 1950, sec. 61-146 to 61-153, inc.

<sup>76</sup> Kentucky Revised Statutes, 1953, sec. 248.430.

<sup>77</sup> *Reaves Warehouse Corporation v. Commonwealth*, 141 Va. 194, 126 S. E. 87; *Motley v. Commonwealth*, 141 Va. 194, 126 S. E. 87; *Danville Warehouse Co., Inc. v. Tobacco Growers' Coop. Association*, 143 Va. 741, 129 S. E. 739; *Jewell Tobacco Warehouse Co. v. Kemper*, 206 Ky. 667, 268 S. W. 324.

<sup>78</sup> See *ante*, p. 109.

<sup>79</sup> *Neillsville Shipping Association v. Lastofka*, 225 Wis. 350, 274 N. W. 280.

<sup>80</sup> *Hy-Grade Dairies v. Falls City Milk Producers' Association*, 261 Ky. 25, 86 S. W. 2d 1046; *Pure Milk Producers' Association of Greater Kansas City Territory v. Bridges*, 146 Kan. 15, 68 P. 2d 658; *Wesemann v. Watertown Milk Coop. Association*, 222 Wis. 475, 269 N. W. 246; *State v. Standard Oil Company*, 130 Tex. 313, 107 S. W. 2d 550.

<sup>81</sup> *Burley Tobacco Growers' Coop. Association v. Devine*, 217 Ky. 320, 289 S. W. 253; *Dark Tobacco Growers' Coop. Association v. Alexander*, 208 Ky. 572, 271 S. W. 677; *South Carolina Cotton Growers' Coop. Association v. English*, 135 S. C. 19, 133 S. E. 542; *Oregon Growers' Coop. Association v. Lentz*, 107 Ore. 561, 212 P. 811; *Kansas Wheat Growers' Association v. Lucas*, 128 Kan. 350, 278 P. 6; *Kansas Wheat Growers' Association v. Loehr*, 125 Kan. 491, 264 P. 735; *Rinnander v. Denver Milk Producers, Inc.*, 114 Colo. 506, 166 P. 2d 984.

farm from a third person and supervised its operations, then the crops grown are not subject to a marketing contract signed by the husband.<sup>82</sup>

Because it was found that a former member of an association had in good faith transferred cows to his son, a nonmember, the association was enjoined from interfering with the marketing of the milk produced by such cows.<sup>83</sup>

In Kentucky, a transfer of land by a member of an association to his wife and son, although made for a valuable consideration, was held void under a statute of that State declaring fraudulent all conveyances of real or personal property made to delay creditors and others, where the person to whom the transfer is made has notice of the fraudulent intent of the person making the transfer.<sup>84</sup> In this case the association recovered liquidated damages of 5 cents per pound for all tobacco grown on the farm in question and disposed of outside the association.

## Conclusive Presumption

MANY of the cooperative statutes contain a provision<sup>85</sup> stating that "it shall be conclusively presumed that a landowner or landlord or lessor is able to control the delivery of products produced on his land by tenants or others" whose tenancy is created after the execution of a marketing contract. This provision in the cooperative acts of Kentucky and Colorado has been upheld by the courts of those States.<sup>86</sup> In the Kentucky cases cited the association recovered liquidated damages from the landlord on account of products grown on his land which were not marketed through the association.

In the two Colorado cases cited the court held that the association was entitled to enjoin the landlord and the tenant in each case, and to recover damages from each of them. In each of the Colorado cases, the tenant knew that the landlord was a member of the association, and the court held that he was charged with notice of the conclusive-presumption provision in the cooperative act of Colorado.

The conclusive-presumption provision in the cooperative act of Louisiana was held by the supreme court of that State to be in conflict with the fourteenth amendment to the Federal Constitution.<sup>87</sup> It has since been deleted from the code.

In the case first cited in footnote 87, the association sought to compel the specific performance of a contract and to recover liquidated damages

<sup>82</sup> *Layne v. Tobacco Growers' Coop. Association*, 147 Va. 878, 133 S. E. 358. See also *Inland Empire Dairy Producers' Association v. Melander*, 134 Wash. 145, 235 P. 12; *Inland Empire Dairy Producers' Association v. Casberg*, 134 Wash. 702, 235 P. 13; *Burley Tobacco Growers' Coop. Association v. Jewell*, 213 Ky. 272, 280 S. W. 1105; *Kansas Wheat Growers' Association v. Lucas*, 128 Kan. 350, 278 P. 6; *Kansas Wheat Growers' Association v. Garnett*, 128 Kan. 337, 278 P. 5.

<sup>83</sup> *Wesemann v. Watertown Milk Coop. Association*, 222 Wis. 475, 269 N. W. 246.

<sup>84</sup> *Coyle v. Dark Tobacco Growers' Coop. Association*, 211 Ky. 162, 277 S. W. 318.

<sup>85</sup> See sec. 18 of the Bingham Cooperative Marketing Act of Kentucky, p. 305 of Appendix.

<sup>86</sup> *Feagain v. Dark Tobacco Growers' Coop. Association*, 202 Ky. 801, 261 S. W. 607; *Dark Tobacco Growers' Coop. Association v. Daniels*, 215 Ky. 67, 284 S. W. 399; *Monte Vista Potato Growers' Coop. Association v. Bond*, 80 Colo. 516, 252 P. 813; *Wilson v. Monte Vista Potato Growers' Coop. Association*, 82 Colo. 428, 260 P. 1080.

<sup>87</sup> *Louisiana Farm Bureau Cotton Growers' Coop. Association v. Clark*, 160 La. 294, 107 So. 115; *Louisiana Farm Bureau Cotton Growers' Coop. Association v. Bannister*, 161 La. 957, 109 So. 776; *Louisiana Farm Bureau Cotton Growers' Coop. Association v. Bacon*, 164 La. 126, 113 So. 790.



for cotton sold outside the association. The cotton had been grown on the share-lease plan and the tenants were not parties to the suit. From the record it did not appear that the "tenants had any knowledge of the marketing agreement of their landlord with said association." The court declared that the legislature had "made an indirect but clear attempt to deprive tenants of their property in cotton raised under the share system of contract, without notice of such marketing contract, and without due process of law of any kind."

Although all persons are charged with knowledge of the law, persons are not charged with knowledge of the membership of cooperatives or with knowledge of the persons that have entered into marketing contracts with an association, in the absence of a statute providing for recordation of such contracts for the purpose of giving constructive notice.

In a Mississippi case,<sup>88</sup> the court expressed doubt concerning the constitutionality of the conclusive-presumption provision and held that it had no application to a marketing contract entered into prior to the passage of the cooperative statute containing the provision.

## Monopoly and Restraint of Trade

TO UNDERSTAND clearly the attitude of the courts toward early cooperative efforts in this country, it is important to have in mind the legal background with respect to monopolies and restraint of trade. For centuries the common law looked askance at anything that appeared to restrain trade or to reduce competition. One could hardly overemphasize the attitude of the early English courts with respect to these matters. Bona fide partnerships were apparently always held to be lawful, although the formation of a partnership might mean a reduction of one or more in the number of traders or dealers.

The common law attitude toward restraint of trade is illustrated by a Washington case<sup>89</sup> involving an association of milk dealers of the city of Seattle, which fixed the price of milk and through which the dealers agreed not to sell to each other's customers. The milk dealers were prosecuted and found guilty of conspiracy under common law principles.

It was early held at common law that if a man sold his business and entered into an agreement with the purchaser that he would not engage in the same business either at that place or any other place, or within a given area for a given period of time, or at any time, the agreement was illegal on the theory that it reduced the seller's opportunities for making a living.<sup>90</sup>

Gradually the attitude of the courts toward contracts of this kind relaxed, and today they are upheld generally, if the restrictions on the right of the seller to engage in business are no greater than is reasonably necessary for the protection of the buyer.<sup>91</sup>

Further light is thrown on the state of the law toward acts deemed to be in restraint of trade by the statute passed by the English Parliament in the reign of Edward VI prohibiting forestalling, engrossing, and regrating.<sup>92</sup>

<sup>88</sup> *Staple Cotton Coop. Association v. Hemphill*, 142 Miss. 298, 107 So. 24.

<sup>89</sup> *State v. Erickson*, 54 Wash. 472, 103 P. 796. See also *People v. Milk Exchange*, 145 N. Y. 267, 45 Am. St. Rep. 609, 39 N. E. 1062, 27 L. R. A. 437, affirming 29 N. Y. S. 259, 77 Hun. 436.

<sup>90</sup> Anson on CONTRACTS, Am. Ed., sec. 255.

<sup>91</sup> *Lumbermen's Trust Co. v. Title Ins. & Inv. Co. of Tacoma*, 248 F. 212.

<sup>92</sup> Statutes at Large, 7 Edw. VI vol. 5, ch. 14.

Forestalling consists of buying victuals on their way to market and before they reach it, with intent to sell again at a higher price.<sup>93</sup>

Engrossing was the buying at any place of certain necessities of life from producers with a view to resale at a higher price. Regrating was the purchase of provisions at a fair or public market for the purpose of resale at a higher price in the same market or in any market within 4 miles thereof. This early English statute restricting trading in victuals and provisions evidences the intention that such products should pass from the original producer to the consumer. In other words, the object of the statute was undoubtedly to keep the bridge short between the producer and the consumer. This statute against forestalling, engrossing, and regrating, as well as the other principles with reference to restraint of trade referred to, all became a part of the common law of this country to a large degree,<sup>94</sup> and this should be kept in mind when considering the attitude of American courts toward early cooperative efforts.

Perhaps because of a change in economic and social conditions and perhaps because of the demonstrated inefficiency of such a statute, part of it was repealed in 1772 and the entire act in 1844.<sup>95</sup>

It is interesting to note that the statute enacted in 1844 by the English Parliament, which included the repeal of the statute against forestalling, engrossing, and regrating, stated that it was being repealed because the prohibited acts had come to be considered as favorable to the development of trade and not as restraining trade.

From the foregoing it is clear that we inherited common law principles and traditions against restraint of trade.

Some of the cases involving cooperatives that were decided by State courts prior to the enactment of cooperative statutes in the States concerned will now be discussed.

An Iowa case, decided in 1913, involving a cooperative, was disposed of in accordance with what the court conceived to be the common law principles applicable. A bylaw of the association provided that any member of the association should forfeit 5 cents for every hundredweight of produce or livestock sold to any competitor of the association. A buyer of hogs, who operated in the territory in which the association functioned, brought an injunction suit to prevent the association from enforcing the bylaw. In holding against the association, the Supreme Court of Iowa held that the bylaw was in restraint of trade because the plaintiff was placed at a disadvantage and could not compete with the society in purchasing hogs from its members, and the members were not free to deal with plaintiff. If they dealt with him, he either forfeited his profits by reason of having to pay too much for his hogs, or they forfeited a part of the purchase price as a penalty for selling to him.<sup>96</sup>

In a Colorado case<sup>97</sup> a bylaw provided that stockholders might sell grain to competitors of the association in a particular town by paying 1 cent per bushel to the association for all grain so sold. A stockholder who had

<sup>93</sup> *Dutton v. Knoxville*, 121 Tenn. 25, 113 S. W. 381, 383, 130 Am. St. Rep. 748, 16 Ann. Cas. 1028.

<sup>94</sup> *State v. Eastern Coal Co.*, 29 R. I. 254, 70 A. 1, 132 Am. St. Rep. 817, 17 Ann. Cas. 96.

<sup>95</sup> *Standard Oil Co. of New Jersey v. United States*, 221 U. S. 1, 55, 31 S. Ct. 502, 55 L. Ed. 619, 34 L. R. A. (N. S.) 834, Ann. Cas. 1912 D 734.

<sup>96</sup> *Reeves v. Decorah Farmers' Coop. Soc.*, 160 Iowa 194, 140 N. W. 844, 44 L. R. A. (N. S.) 1104; followed in *Ludowese v. Farmers' Mut. Coop. Co.*, 164 Iowa 197, 145 N. W. 475.

<sup>97</sup> *Burns v. Wray Farmers' Grain Co.*, 65 Colo. 425, 176 P. 487, 11 A. L. R. 1179; followed in *Atkinson v. Colorado Wheat Growers' Association*, 77 Colo. 559, 238 P. 1117.

agreed to the bylaw sold 3,500 bushels of grain to a competitor of the association and the cooperative brought suit against him to recover \$35. The bylaw was held invalid on the ground that it was in restraint of competition and the association lost the suit.

It is interesting to note that the Colorado cases followed the Iowa cases. Other cases in which the courts held against the cooperatives involved, on the ground that they were operating in restraint of trade, are here given.<sup>98</sup>

In each of the States in which decisions were rendered that were adverse to cooperation, later cases have been decided favorable to cooperation. In Iowa<sup>99</sup> the supreme court of that State upheld the right of an association formed under the cooperative act passed in 1921, which provided that associations formed under it might provide for liquidated damages in their contracts, to recover liquidated damages. In upholding the liquidated damages clause in the contract of the association and the validity of the association in general, the court apparently was of the opinion that the association was legal at common law, but in response to the argument that the cooperative act under which the association was organized violated an earlier statute of the State prohibiting pools and trusts, in that it authorized associations to provide for liquidated damages, the court said that the cooperative act "is as much a declaration of public policy as the earlier statute referring to pools and trusts."

In Colorado the supreme court of that State in upholding cooperatives held that the public policy of the State had been expressly changed by the cooperative act enacted in 1923.<sup>1</sup>

Not all of the early cases involving cooperation were adverse to the associations concerned. In Illinois, New York, and Alabama<sup>2</sup> it was held, apparently in pursuance of common law principles, that the associations involved were not operating in restraint of trade even though their contracts, or bylaws, provided for liquidated damages. In Indiana<sup>3</sup> the supreme court of that State, applying common law principles, upheld the cooperative and held that it was not operating in restraint of trade.

Nearly all of the States, comparatively early in their history, included provisions in their constitutions or statutes prohibiting monopolies, trusts, and restraint of trade. Efforts were made to except associations of farmers from these prohibitions, either by including an exception in the statute or by a provision in the constitution. For instance, in 1893, the State of Illinois passed an antitrust act, which declared that "the provisions of this act shall not apply to agricultural products while in the hands of the producer or raiser." This provision was later made the basis for a decision by the Supreme Court of the United States in the famous Connolly case.<sup>4</sup>

Briefly, the facts in the case were these: Connolly was indebted to the Union Sewer Pipe Co. on two notes given on account of the purchase by

<sup>98</sup> *Georgia Fruit Exchange v. Turnipseed*, 9 Ala. App. 123, 62 So. 542; *Ford v. Chicago Milk Shippers' Association*, 155 Ill. 166, 39 N. E. 651, 27 L. R. A. 298.

<sup>99</sup> *Clear Lake Coop. Live Stock Shippers' Association v. Weir*, 200 Iowa 1293, 206 N. W. 297.

<sup>1</sup> *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *Austin v. Colorado Dairymen's Coop. Association*, 81 Colo. 546, 256 P. 640.

<sup>2</sup> *Milk Producers' Marketing Co. v. Bell*, 234 Ill. App. 222; *Bullville Milk Producers' Association v. Armstrong*, 178 N. Y. S. 612; 108 Misc. Rep. 582; *Castorland Milk & Cheese Co. v. Shantz*, 179 N. Y. S. 131; *Ex parte Baldwin County Producers' Corporation*, 203 Ala. 345, 83 So. 69.

<sup>3</sup> *Burley Tobacco Society v. Gillaspie*, 51 Ind. App. 583, 100 N. E. 89.

<sup>4</sup> *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 540, 22 S. Ct. 431, 46 L. Ed. 679; a similar conclusion was reached in Georgia in a like case, *Brown v. Jacobs' Pharmacy Co.*, 115 Ga. 429, 41 S. E. 553, 57 L. R. A. 547, 90 Am. St. Rep. 126.



him of some sewer pipe. When sued on the notes, Connolly claimed that the plaintiff was a trust, and as the antitrust act specifically stated that any purchaser of any article from any corporation operating as a trust was not liable for the purchase price, that he could not be held for the purchase price of the pipe. The Sewer Pipe Co. claimed that the Anti-Trust Act of Illinois was void because it exempted products in the hands of the producer, which exemption, it contended, violated the fourteenth amendment to the Constitution, to wit, the equal-protection clause. The Federal district court, in which it originated, held that this was true, and the Supreme Court of the United States affirmed the decision.

In 1889, Texas enacted an antitrust act which contained language exempting agriculture identical with that contained in the Illinois act. The legality of this provision in the Texas act was questioned in a Federal court, which held that it violated the equal-protection clause in the fourteenth amendment.<sup>5</sup>

A provision in the Colorado Anti-Trust Act excepting therefrom any combination or association "the object and business of which are to conduct its operations at a reasonable profit or to market at a reasonable profit those products which cannot otherwise be so marketed," caused the United States Supreme Court to hold the statute invalid.<sup>6</sup> The Court said: "Such an exception in the statute leaves the whole statute without a fixed standard of guilt in an adjudication affecting the liberty of the one accused." The Anti-Trust Act of California was amended so as to contain a similar exception and this statute was likewise held invalid.<sup>7</sup>

Inasmuch as the Supreme Court of the United States found that the Court of Appeals of Kentucky had construed the constitution, the anti-trust statute, and the statute of that State authorizing persons to pool crops of wheat, tobacco, and other farm products raised by them "for the purpose of obtaining a higher price than they could get by selling them separately," as meaning that "any combination for the purpose of controlling prices" was lawful "unless for the purpose or with the effect of fixing a price that was greater or less than the real value of the article," it held the anti-trust statute unconstitutional as affording no standard of conduct that could be known in advance and complied with.<sup>8</sup> On similar grounds, a statute of Kentucky was held unconstitutional in a case in which a farmer had entered into a pooling contract covering his tobacco and then had disposed of his tobacco contrary to such contract, thereby violating such statute.<sup>9</sup>

The effect of the decision by the Supreme Court of the United States in the Connolly case and of the lower Federal court in the Texas case was to invalidate the antitrust statutes of the States in question, assuming that the court decisions in question were given full force and effect. On reflection it will be appreciated that this conclusion is distinctly different from holding that farmers are barred from forming cooperatives. On the contrary, the effect of the decisions referred to, and of any other similar decisions that might be rendered, is merely to leave a State without any antitrust legislation. It is believed that the decision of the United States Supreme Court, rendered in 1928, in a case involving the Burley Tobacco Growers'

<sup>5</sup> *In re Grice*, 79 F. 627, 169 U. S. 284, 18 S. Ct. 323, 42 L. Ed. 748.

<sup>6</sup> *Cline v. Frink Dairy Company*, 274 U. S. 445, 457, 47 S. Ct. 681, 71 L. Ed. 1146, modifying *Beatrice Creamery Co. v. Cline*, 9 F. 2d 176.

<sup>7</sup> *Blake v. Paramount Pictures*, 22 F. Supp. 249.

<sup>8</sup> *International Harvester Company v. Kentucky*, 234 U. S. 216, 220, 221, 34 S. Ct. 853, 58 L. Ed. 1284.

<sup>9</sup> *Collins v. Kentucky*, 234 U. S. 634, 34 S. Ct. 924, 58 L. Ed. 1510.

Cooperative Association, indicated a change of attitude on the part of that court toward the right of States to provide expressly for the organization of associations,<sup>10</sup> and in 1940 the Connolly case was specifically overruled.<sup>11</sup>

The so-called standard marketing act contains a provision<sup>12</sup> stating that associations organized thereunder:

\* \* \* shall be deemed not to be a conspiracy nor a combination in restraint of trade nor an illegal monopoly; nor an attempt to lessen competition or to fix prices arbitrarily or to create a combination or pool in violation of any law of this state; and the marketing contracts and agreements between the association and its members and any agreement authorized in this act shall be considered not to be illegal nor in restraint of trade. \* \* \*

Statutes generally similar have been enacted in most of the States.

In an Ohio case<sup>13</sup> involving a milk bargaining association, incorporated under a cooperative statute containing a provision like that quoted above, the court stated that "unless contracts made under and by virtue of this act are in their restraint of trade unreasonable as to character, scope or operation, they are valid and binding obligations." Thus, the court did not give the statutory provision in question a literal interpretation.

The Supreme Court of Florida refused to hold the antitrust statute of that State unconstitutional because agricultural and horticultural nonprofit associations were exempt therefrom by the terms of that statute and by the cooperative marketing act of the State. The court said:

Orderly, systematized cooperative marketing associations which are authorized to prevent a sacrifice of the products described in the exempting statutes and to realize reasonable profits thereon have no analogy to financial combinations in restraint of trade and by a parity of reason no analogy to combinations of skill and labor in the same enterprises to accomplish the same lawful purposes.<sup>14</sup>

In a Texas case<sup>15</sup> decided by an intermediate court, it appeared that producers began the formation of an association with the intention of incorporating under the cooperative act of Texas; but they failed to incorporate, and later sought to enjoin a member from violating his contract. The court held that the contract of the association violated the antitrust act of the State, but it also held that if the association had been incorporated under the cooperative act of Texas it would have been exempt from the antitrust act by reason of the exemption language contained in the act. In a later case,<sup>16</sup> however, in which the State of Texas had instituted civil proceedings against certain oil companies for the recovery of penalties, it was contended by the oil companies that inasmuch as the penal code of Texas purported to exempt agricultural products and livestock from the operations of the penal antitrust laws so long as they were in the hands of the producer and as the Cooperative Marketing Act of Texas contained a provision like that given above, the civil antitrust laws of Texas were invalid under the fourteenth amendment of the Constitution of the United States. In holding otherwise the court pointed out that the exemption

<sup>10</sup> *Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Association*, 276 U. S. 71, 48 S. Ct. 291, 72 L. Ed. 473, affirming 208 Ky. 643, 271 S. W. 695.

<sup>11</sup> *Tigner v. Texas*, 310 U. S. 141, 60 S. Ct. 879, 84 L. Ed. 1124, 130 A. L. R. 1321.

<sup>12</sup> See sec. 28 of the Bingham Cooperative Marketing Act of Kentucky, p. 307 of Appendix.

<sup>13</sup> *Stark County Milk Producers' Association v. Tabeling*, 129 Ohio St. 159, 194 N. E. 16, 19, 98 A. L. R. 1393; *Hanna, John. COOPERATIVE MILK MARKETING AND RESTRAINT OF TRADE*, 23 Ky. L. J. 217 (1935).

<sup>14</sup> *Brock v. Hardie*, 114 Fla. 670, 154 So. 690, 695. See also *Williams v. Quill*, 277 N. Y. 1, 12 N. E. 2d 547, appeal dismissed, 303 U. S. 621, 58 S. Ct. 650, 82 L. Ed. 1085.

<sup>15</sup> *Fisher v. El Paso Egg Producers' Association*, 278 S. W. 262 (Tex. Civ. App.).

<sup>16</sup> *State v. Standard Oil Co.*, 130 Tex. 313, 107 S. W. 2d 550, 557.

from the penal statute did not affect the civil antitrust laws of the State because the latter are distinct and separate from the former. A majority of the court was of the view that even if the provision in the Cooperative Marketing Act of the State purporting to exempt cooperatives from the antitrust laws was to be construed as having this effect, this did not invalidate the State's antitrust laws. The court, however, in what appear to be dicta, expressed the view that if the exemption provision was to be so construed this might invalidate, at least in part, the Cooperative Marketing Act of the State. In this connection the court said:

\* \* \* that a corporation created under this act may do the legitimate things for which it is created. We do not assume that they will make contracts or adopt methods of carrying on their business in clear violation of the antitrust laws. \* \* \* If it should be held, however, that the Cooperative Marketing Act was intended to give the corporations to be formed thereunder the power and authority to do any of the things denounced by our antitrust laws, and should it further be held that the giving of such power and authority created an unreasonable and unconstitutional classification in favor of such corporations, such holdings would render the Cooperative Marketing Act, at least to that extent, unconstitutional; and if it should be held that the Cooperative Marketing Act, or any of its provisions, is unconstitutional, such holding would not in any way affect the antitrust laws.

The Chief Justice expressed the personal opinion that the purpose of the exemption was to exempt marketing associations from the operation of the antitrust laws of the State and because of this purpose that it was null and void, being in conflict with a provision of the constitution of the State which declares that "all free men, when they form a social compact, have equal rights." In this connection he pointed out that the exemption in the statute was not in favor of farmers as a class but simply in favor of corporations of farmers incorporated under this particular act and said that a construction of the statute "granting immunity to corporations composed of farmers, but at the same time denying immunity to farmers individually and to unincorporated associations of farmers for similar purposes—is of course condemned by our Constitutions, both State and Federal."

Many large-scale associations have been formed in various States under the standard marketing act. Questions pertaining to the validity of this statute and the legality of the associations formed under it, and especially as to whether the associations were monopolies or were restraining trade, have been repeatedly before the courts.<sup>17</sup>

The exact basis for the conclusion of the court in each instance that the

<sup>17</sup> *Jellesma v. Tampa Better Milk Producers' Association*, 109 Fla. 200, 147 So. 463; *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231; *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311; *Oregon Growers' Coop. Association v. Lentz*, 107 Ore. 561, 212 P. 811; *Brown v. Staple Cotton Coop. Association*, 132 Miss. 859, 96 So. 849; *Northern Wisconsin Coop. Tobacco Pool v. Bekkedal*, 182 Wis. 571, 197 N. W. 936; *Dark Tobacco Growers' Coop. Association v. Dunn*, 150 Tenn. 614, 266 S. W. 308; *Potter v. Dark Tobacco Growers' Coop. Association*, 201 Ky. 441, 257 S. W. 33; *Colma Vegetable Association v. Bonetti*, 91 Cal. App. 103, 267 P. 172; *Dark Tobacco Growers' Coop. Association v. Mason*, 150 Tenn. 228, 263 S. W. 60; *Minnesota Wheat Growers' Coop. Marketing Association v. Huggins*, 162 Minn. 471, 203 N. W. 420; *List v. Burley Tobacco Growers' Coop. Association*, 114 Ohio St. 361, 151 N. E. 471; *Washington Cranberry Growers' Association v. Moore*, 117 Wash. 430, 201 P. 773, 204 P. 811, 25 A. L. R. 1077; *Phez Co. v. Salem Fruit Union*, 103 Ore. 514, 201 P. 222, 205 P. 970, 25 A. L. R. 1090; *Burley Tobacco Growers' Coop. Association v. Rogers*, 88 Ind. App. 469, 150 N. E. 384; *Nebraska Wheat Growers' Association v. Norquest*, 113 Neb. 731, 204 N. W. 798; *Clear Lake Coop. Live Stock Shippers' Association v. Weir*, 200 Iowa 1293, 206 N. W. 297; *Lee v. Clearwater Growers' Association*, 93 Fla. 214, 111 So. 722; *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937. See also 41 C. J. 166.



association involved was not a monopoly, or was not engaged in restraint of trade from a legal standpoint, varies, but all the cases, either expressly<sup>18</sup> or by implication,<sup>19</sup> hold that the statutory public policy of the State has been changed so as to render legal associations which, under old standards, would have been regarded as illegal. This line of reasoning appears to be correct in all instances in which a State has enacted a statute, or statutes, providing for the incorporation and organization of associations of farmers.

Clearly, if a State has enacted a statute providing for the incorporation of associations of producers and authorizing such associations to enter into contracts with their members covering the handling and marketing of their produce, such a statute should take precedence over a prior statute of the State against trusts and restraint of trade.<sup>20</sup> It should be remembered that all the statutes that have been enacted during recent years for the incorporation and operation of associations of producers were enacted subsequent to the antitrust statutes of the States in question. The last statute is an expression of the legislature of the State of equal rank with the earlier expression of the State legislature, and the fact that it is of later date causes it to modify the earlier statute against restraint of trade.<sup>21</sup>

This is true whether or not the cooperative act under which the association is formed contains a provision declaring that associations formed thereunder are not to be deemed to be in restraint of trade. In fact, the courts in many of the cases decided under cooperative statutes containing this exemption clause have not referred in their opinions to this provision.

In some instances cases have arisen in which the antitrust prohibitions of the State were contained in its constitution. Of course, in instances of this kind, it was necessary for the court to find that the association was not, in fact, within the scope of this provision of the constitution.<sup>22</sup>

In a few instances the courts have attached some significance to the fact that the association was formed under a cooperative statute that contained a provision in effect expressly exempting associations formed thereunder from the antitrust laws of the State.<sup>23</sup>

In one case<sup>24</sup> a cooperative, along with other corporations and business units, was sued by the State of Wisconsin, the complaint charging a violation of the State's antitrust laws. The basis of the complaint was that the defendants, which distributed 94 percent of the fluid milk in Milwaukee County, had maintained uniform prices after meetings between them. The court held that the complaint stated a cause of action since an agreement to fix prices could be inferred from the uniformity after they had been together in a meeting. This case also illustrates that a cooperative although free to organize may be capable of engaging in practices which violate the State's antitrust laws.

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<sup>18</sup> *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *Northern Wisconsin Coop. Tobacco Pool v. Bekkedal*, 182 Wis. 571, 197 N. W. 936; *Kansas Wheat Growers' Association v. Schulte*, 113 Kan. 672, 216 P. 311.

<sup>19</sup> *Brown v. Staple Cotton Coop. Association*, 132 Miss. 859, 96 So. 849; *List v. Burley Tobacco Growers' Coop. Association*, 114 Ohio St. 361, 151 N. E. 471.

<sup>20</sup> *Clear Lake Coop. Live Stock Shippers' Association v. Weir*, 200 Iowa 1293, 206 N. W. 297.

<sup>21</sup> *Rifle Potato Growers' Coop. Association v. Smith*, 78 Colo. 171, 240 P. 937; *Northern Wisconsin Coop. Tobacco Pool v. Bekkedal*, 182 Wis. 571, 197 N. W. 936; *Clear Lake Coop. Live Stock Shippers' Association v. Weir*, 200 Iowa 1293, 206 N. W. 297.

<sup>22</sup> *Brown v. Staple Cotton Coop. Association*, 132 Miss. 859, 96 So. 849.

<sup>23</sup> *Lee v. Clearwater Growers' Association*, 93 Fla. 214, 111 So. 722; *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231.

<sup>24</sup> *State v. Golden Guernsey Dairy Cooperative*, 257 Wis. 254, 43 N. W. 2d 31.

In 1890 Congress passed the Sherman Anti-Trust Act,<sup>25</sup> the first section of which reads as follows:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding \$5,000, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

At the time that the Sherman Act was under consideration in Congress an amendment was offered thereto reading as follows:

*Provided, That this act shall not be construed to apply to any arrangements, agreements or combinations between laborers made with a view of lessening the number of hours of their labor or of increasing their wages; nor to any arrangements, agreements, associations, or combinations among persons engaged in horticulture or agriculture made with the view of enhancing the price of their own agricultural or horticultural products.*

This amendment was defeated.<sup>26</sup>

In construing this statute the United States Supreme Court has repeatedly held that only unreasonable restraints are prohibited thereby.<sup>27</sup>

In the cases just cited the Supreme Court announced the so-called "rule of reason." It is now settled that under the Federal antitrust acts the courts are primarily concerned with how the defendant employs its power and strength, and the legality of a large industrial unit depends not on its size but upon the character of the business methods employed. During the past decade and more, courts have shown an increasingly liberal attitude toward large-scale organizations. Bigness which has come about through development along normal lines and without unfair practices or wrongful acts does not constitute illegality.

In the case of the *United States v. United States Steel Corporation*,<sup>28</sup> the legality of this corporation, a combination of approximately 180 separate units, was involved, but the court applied the principles referred to, and although the corporation controlled 50 percent of the steel industry of the United States it was held not to be in restraint of trade. However, size "is an earmark of monopoly power."<sup>29</sup>

In the case of *Chicago Board of Trade v. United States*<sup>30</sup> the legality of a rule adopted by the Board of Trade of Chicago which prohibited its members from purchasing or offering to purchase, during the period between the session of the board termed the "call" and the opening of the regular session of the next business day, grain "to arrive" at a price other than the closing bid at the "call," was held not to violate the Sherman Act. In this case it was said, "The true test of legality is whether the restraint

<sup>25</sup> 26 Stat. 209, 15 U. S. C. A. 1.

<sup>26</sup> 21 Cong. Rec. 2726 (1890).

<sup>27</sup> *Standard Oil Co. of New Jersey v. United States*, 221 U. S. 1, 31 S. Ct. 502, 55 L. Ed. 619, 34 L. R. A. (N. S.) 834, Ann. Cas. 1912D 734; *United States v. American Tobacco Co.*, 221 U. S. 106, 31 S. Ct. 632, 55 L. Ed. 663; *Apex Hosiery Company v. Leader*, 310 U. S. 469, 60 S. Ct. 982, 84 L. Ed. 1311. See also *United States v. American Medical Association*, 110 F. 2d 703, affirmed, 317 U. S. 519, 63 S. Ct. 326, 87 L. Ed. 434.

<sup>28</sup> *United States v. United States Steel Corporation*, 251 U. S. 417, 40 S. Ct. 293, 64 L. Ed. 343, 8 A. L. R. 1121.

<sup>29</sup> *United States v. Griffith*, 334 U. S. 100, 68 S. Ct. 941, 92 L. Ed. 1236; *United States v. Columbia Steel Co.*, 334 U. S. 495, 68 S. Ct. 1107, 92 L. Ed. 1533.

<sup>30</sup> *Board of Trade of the City of Chicago v. United States*, 246 U. S. 231, 38 S. Ct. 242, 62 L. Ed. 683.

imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition."

A case which well illustrates the "rule of reason" is that of the *National Window Glass Manufacturers v. United States*,<sup>31</sup> in which the Supreme Court of the United States passed upon a situation in which all the manufacturers of hand-blown glass and all the labor (union) to be had for this work entered into an arrangement under which it was agreed that certain of the factories only would operate for a specified period during which all the labor would be employed by those factories; then, during another specified period, the remainder of the factories would operate with all the labor, and the other factories would not then operate. In view of all the facts involved, it was held that there was no violation of the law. It is true that the court referred to the fact that the price of glass was virtually determined by those engaged in the manufacture of machine-blown glass, but the fact remains that an economic arrangement, involving the complete closing of certain factories during a specified period and the operation of only certain other factories during that period, was upheld.

In a case<sup>32</sup> involving an organization of coal producers the Supreme Court in upholding the legality of the organization said:

The mere fact that the parties to an agreement eliminate competition between themselves is not enough to condemn it.

The court further said:

The fact that the correction of abuses may tend to stabilize a business, or to produce fairer price levels, does not mean that the abuses should go uncorrected or that cooperative endeavor to correct them necessarily constitutes an unreasonable restraint of trade.

The Supreme Court has also declared that those engaged in the same line of business may, through their trade associations, freely exchange information regarding goods on hand, the amount of unfilled orders, and the prices at which sales have been made.<sup>33</sup>

The court has, however, refused to apply the "rule of reason" in instances in which manufacturers of the same product have agreed upon a schedule of prices.<sup>34</sup> In cases of this character the court regards the fixing of prices as in itself a violation of the Sherman Act and will not inquire into the reasonableness of such prices.

The Sherman Act contains a provision authorizing any private person who is injured in his business or property by anything forbidden or declared to be unlawful by that act, to sue for treble damages. Apparently a cooperative cannot, merely by virtue of its cooperative character, maintain an action for treble damages on account of damage sustained by its individual members, and it must state a clear case of damage to itself as a corporation to maintain a suit.<sup>35</sup>

The following cases are illustrative of situations in which cooperatives

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<sup>31</sup> *National Association of Window Glass Manufacturers v. United States*, 263 U. S. 403, 44 S. Ct. 148, 68 L. Ed. 358.

<sup>32</sup> *Appalachian Coals, Inc. v. United States*, 288 U. S. 344, 360, 374, 53 S. Ct. 471, 77 L. Ed. 825.

<sup>33</sup> *Maple Flooring Manufacturers' Association v. United States*, 268 U. S. 563, 45 S. Ct. 578, 69 L. Ed. 1093; *Cement Manufacturers' Protective Association v. United States*, 268 U. S. 588, 45 S. Ct. 586, 69 L. Ed. 1104.

<sup>34</sup> *United States v. Trenton Potteries Co.*, 273 U. S. 392, 47 S. Ct. 377, 71 L. Ed. 700.

<sup>35</sup> *Farmers Coop. Oil Co. v. Socony-Vacuum Oil Co., Inc.*, 133 F. 2d 101, 51 F. Supp. 440. See also *Louisiana Farmers' Protective Union, Inc. v. Great Atlantic & Pacific Tea Company of America, Inc.*, 131 F. 2d 419.



were protected by the antitrust laws from courses of action adopted by third persons which, if unchallenged, would have seriously hampered the organizations. A tobacco marketing association was granted relief from an illegal exclusion from market.<sup>36</sup> A group health cooperative was granted relief from illegal opposition by the American Medical Association and a local medical society.<sup>37</sup> Another health cooperative obtained injunctive relief against a local medical society in a State court.<sup>38</sup>

The act of Congress<sup>39</sup> approved July 2, 1926, directing the Secretary of Agriculture to establish a division of cooperative marketing in the Department of Agriculture, contains a provision reading as follows:

Persons engaged, as original producers of agricultural products, such as farmers, planters, ranchmen, dairymen, nut or fruit growers, acting together in association, corporate or otherwise, in collectively processing, preparing for market, handling, and marketing in interstate and/or foreign commerce such products of persons so engaged, may acquire, exchange, interpret, and disseminate past, present, and prospective crop, market, statistical, economic, and other similar information by direct exchange between such persons, and/or such associations or federations thereof, and/or by and through a common agent created or selected by them.

This provision confers broad authority on producers and their associations to acquire and exchange information pertaining to the production and marketing of crops.

### Section 6 of the Clayton Act

Following the passage of the Sherman Act, as larger and larger marketing and bargaining associations of producers were formed, the question of the application of the Sherman Act to such associations claimed the attention of agricultural leaders. To clarify the situation, when the Clayton Act<sup>40</sup> was enacted in 1914, language was included in section 6 thereof with reference to the status of organizations of farmers. This section reads as follows:

That the labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

It seems to be generally agreed that this section appears to prevent the dissolution of an organization which meets the conditions it prescribes, namely, that it is a "labor, agricultural, or horticultural organization;" that it is "instituted for the purposes of mutual help," and does not have "capital stock;" and last, is not "conducted for profit." However, the few decisions of the courts relative to this section indicate that it does not enable such organizations, if they desire, to adopt methods of conducting their operations denied to other lawful business organizations. In a case<sup>41</sup>

<sup>36</sup> *American Federation of Tobacco Growers, Inc. v. Neal*, 183 F. 2d 869.

<sup>37</sup> *American Medical Association v. United States*, 317 U. S. 519, 63 S. Ct. 326, 87 L. Ed. 434.

<sup>38</sup> *Group Health Cooperative of Puget Sound v. King County Medical Soc.*, 237 P. 2d 737 (Wash.).

<sup>39</sup> 44 Stat. 803, 7 U. S. C. A. 451.

<sup>40</sup> 38 Stat. 730, 731, 15 U. S. C. A. 12.

<sup>41</sup> *Duplex Printing Press Co. v. Deering*, 254 U. S. 443, 469, 41 S. Ct. 172, 65 L. Ed. 349, 16 A. L. R. 196. See also *Buyer v. Guillan*, 271 F. 65; *United States v. Borden Company*, 308 U. S. 188, 60 S. Ct. 182, 84 L. Ed. 181, reversing 28 F. Supp. 177; *Apex Hosiery Company v. Leader*, 310 U. S. 469, 60 S. Ct. 982, 84 L. Ed. 1311.

decided by the Supreme Court involving the legality of a secondary boycott by a labor organization it was said:

\* \* \* As to [section] 6, it seems to us its principal importance in this discussion is for what it does *not* authorize, and for the limit it sets to the immunity conferred. The section assumes the normal objects of a labor organization to be legitimate, and declares that nothing in the antitrust laws shall be construed to forbid the existence and operation of such organizations or to forbid their members for *lawfully* carrying out their *legitimate* objects; and that such an organization shall not be held in itself—merely because of its existence and operation—to be an illegal combination or conspiracy in restraint of trade. But there is nothing in the section to exempt such an organization or its members from accountability where it or they depart from its normal and legitimate objects and engage in an actual combination or conspiracy in restraint of trade. And by no fair or permissible construction can it be taken as authorizing any activity otherwise unlawful, or enabling a normally lawful organization to become a cloak for an illegal combination or conspiracy in restraint of trade as defined by the antitrust laws.

In a case<sup>42</sup> involving solely a farmer cooperative the Department of Justice brought a criminal complaint for violations of the Federal antitrust laws. The United States district court, without mentioning the Sherman Act, dismissed the indictment against the cooperative on the sole grounds of section 6 of the Clayton Act. The court said a farmer cooperative, acting alone and not in concert with others, cannot be prosecuted as a monopoly, for to do so would “\* \* \* scuttle the plain language of the Clayton Act as to cooperatives, as antilabor courts scuttled the labor provisions of the same Act \* \* \*.”

In a certain case,<sup>43</sup> the Aroostook Potato Shippers' Association, acting through a committee, blacklisted certain buyers of potatoes. Members of the association were forbidden, under penalty, to deal with such buyers. Persons outside the association who dealt with persons so blacklisted were also blacklisted and boycotted. The defendants, members of the association, were indicted for a conspiracy in restraint of trade and were fined. The court said with reference to the contention that section 6 relieved the defendants:

\* \* \* I do not think that the coercion of outsiders by a secondary boycott, which was discussed in my opinion on the former indictment, can be held to be a lawful carrying out of the legitimate objects of such an association. That act means, as I understand it, that organizations such as it describes are not to be dissolved and broken up as illegal, nor held to be combinations or conspiracies in restraint of trade; but they are not privileged to adopt methods of carrying on their business which are not permitted to other lawful associations.

Section 6 of the Clayton Act is still in effect and is not repealed by the Capper-Volstead Act.

### **Capper-Volstead Act**

The Capper-Volstead Act became a law on February 18, 1922. It is entitled “An act to authorize association of producers of agricultural products,” and reads as follows:

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged. Such associations may have marketing agencies in common; and such associations and their members may make the necessary contracts and agreements to effect such purposes: *Provided,*

<sup>42</sup> *United States v. Dairy Coop. Association*, 49 F. Supp. 475.

<sup>43</sup> *United States v. King*, 229 F. 275, 250 F. 908, 910.

however, That such associations are operated for the mutual benefit of the members thereof, as such producers, and conform to one or both of the following requirements:

First. That no member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein, or,

Second. That the association does not pay dividends on stock or membership capital in excess of 8 per centum per annum.

And in any case to the following:

Third. That the association shall not deal in the products of nonmembers to an amount greater in value than such as are handled by it for members.

SEC. 2. That if the Secretary of Agriculture shall have reason to believe that any such association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced by reason thereof, he shall serve upon such association a complaint stating his charge in that respect, to which complaint shall be attached or contained therein, a notice of hearing, specifying a day and place not less than thirty days after the service thereof, requiring the association to show cause why an order should not be made directing it to cease and desist from monopolization or restraint of trade. An association so complained of may at the time and place so fixed show cause why such order should not be entered. The evidence given on such a hearing shall be taken under such rules and regulations as the Secretary of Agriculture may prescribe, reduced to writing, and made a part of the record therein. If upon such hearing the Secretary of Agriculture shall be of the opinion that such association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced thereby, he shall issue and cause to be served upon the association an order reciting the facts found by him, directing such association to cease and desist from monopolization or restraint of trade.<sup>44</sup> On the request of such association or if such association fails or neglects for thirty days to obey such order, the Secretary of Agriculture shall file in the district court in the judicial district in which such association has its principal place of business a certified copy of the order and of all the records in the proceeding, together with a petition asking that the order be enforced, and shall give notice to the Attorney General and to said association of such filing. Such district court shall thereupon have jurisdiction to enter a decree affirming, modifying, or setting aside said order, or enter such other decree as the court may deem equitable, and may make rules as to pleadings and proceedings to be had in considering such order. The place of trial may, for cause or by consent of parties, be changed as in other causes.

The facts found by the Secretary of Agriculture and recited or set forth in said order shall be prima facie evidence of such facts, but either party may adduce additional evidence. The Department of Justice shall have charge of the enforcement of such order. After the order is so filed in such district court and while pending for review therein the court may issue a temporary writ of injunction forbidding such association from violating such order or any part thereof. The court may, upon conclusion of its hearing, enforce its decree by a permanent injunction or other appropriate remedy. Service of such complaint and of all notices may be made upon such association by service upon any officer or agent thereof engaged in carrying on its business, or on any attorney authorized to appear in such proceeding for such association, and such service shall be binding upon such association, the officers, and members thereof.<sup>45</sup>

Section 6 of the Clayton Act refers only to nonstock organizations, so that an association of producers formed with capital stock would not be entitled to the benefits thereof. Owing to this fact and for the further purpose of making the status of the associations of producers under the Federal antitrust laws more clear than was done by section 6 of the Clayton Act, the Capper-Volstead Act was passed.

<sup>44</sup> Mr. Lenroot, during the debate on this bill in Congress said: "If the Secretary of Agriculture finds that there is a monopolization or restraint of trade, and also an undue enhancement of price, then under the bill as it would read if amended he is directed to issue an order, not against the undue enhancement of price, but against the monopolization or restraint of trade. In other words, when these facts exist the order goes against the monopoly, against the restraint of trade, and the command will be that they must desist from such monopolization or restraint of trade; and a mere abandonment of the undue enhancement of price will not be a defense." 62 Cong. Rec. 2269 (1922).

<sup>45</sup> 42 Stat. 388; 7 U. S. C. A. 291 and 292.



Mr. Volstead, in discussing the bill said:

The objection made to these organizations at present is that they violate the Sherman Antitrust Act, and that is upon the theory that each farmer is a separate business entity. When he combines with his neighbor for the purpose of securing better treatment in the disposal of his crops, he is charged with a conspiracy or combination contrary to the Sherman Antitrust Act. Businessmen can combine by putting their money into corporations, but it is impractical for farmers to combine their farms into similar corporate form. The object of this bill is to modify the laws under which business organizations are now formed, so that farmers may take advantage of the form of organization that is used by business concerns. It is objected in some quarters that this repeals the Sherman Antitrust Act as to farmers. That is not true any more than it is true that a combination of two or three corporations violates the act. Such combinations may or may not monopolize or restrain trade. Corporations today have all sorts of subsidiary companies that operate together, and no one claims they violate this act.<sup>46</sup>

Senator Capper in discussing the bill said: <sup>47</sup>

Mr. President, the cooperative marketing bill as it was offered in both the Senate and House seeks simply to make definite the law relating to cooperative associations of farmers and to establish a basis on which these organizations may be legally formed. Its purpose is to give to the farmer the same right to bargain collectively that is already enjoyed by corporations. The bill is designed to make affirmative and unquestioned the right which already is generally admitted, but which, in view of the Sherman law, is subject to nullifying interpretation by those whose interests are not identical with those of the farmer, and who for one reason or another may be in a position to obtain an interpretation advantageous to themselves and embarrassing or detrimental to the members of cooperative organization. \* \* \*

While it seems evident that Congress intends that the farmer shall not be prosecuted for acting collectively in the marketing of his product, yet the Federal law is such that these prosecutions may be threatened or actually brought against him. The farmer does not relish the possibility of being prosecuted for an alleged violation of law, even though he feels fairly certain that he would not be convicted.

Prior to the enactment of the Capper-Volstead Act there was at least uncertainty as to whether the elimination of the competition among farmers by their acting through a cooperative did not constitute a violation of the antitrust statutes.<sup>48</sup> The act, which in effect is an amendment of the antitrust statutes, authorizes and sanctions the elimination of such competition.

In the opinion of the writer the fundamental object and result of the Capper-Volstead Act are to authorize farmers to unite in organizations that may or may not be incorporated, which organizations, insofar as the assembling, the processing, the handling and the marketing of the products dealt in by the association are concerned, may act with the same force and effect as though all the agricultural products in question were being handled by one farmer.<sup>49</sup>

The reports of the committees of Congress that reported out the measure and the debates in Congress with reference thereto show that it was the intention of Congress that the Capper-Volstead Act should exempt associa-

<sup>46</sup> 61 Cong. Rec. 1033 (1921).

<sup>47</sup> 62 Cong. Rec. 2057, 2059 (1922).

<sup>48</sup> "The uncertainty of the legal status of farm organizations which conduct business in a collective way has had a paralyzing effect on the efforts of men and associations who are brought together so that they may more economically and efficiently administer their affairs. In some sections of the country, I am informed, officers and members of such organizations have been arrested, indicted, and even thrown into prison." Mr. Calder, in the debate in the Senate concerning the Capper-Volstead Act; 62 Cong. Rec. 2217 (1922). For a discussion of instances in which the officers of cooperative associations were arrested on account of alleged violations of antitrust laws, see article entitled THE BATTLE OF MILK by Professor Boyle, deceased (formerly of Cornell University), in the Saturday Evening Post of November 13, 1937.

<sup>49</sup> See *Minnesota Wheat Growers Coop. Marketing Association v. Huggins*, 162 Minn. 471, 203 N. W. 420.

tions of farmers, when they operate along normal business lines, from the Federal antitrust statutes. In other words, the fact that an association that meets the conditions of the act controls the handling and marketing of all of a given agricultural product would not of itself, standing alone, cause the organization to be in violation of such statutes, and the restraint of trade caused thereby would not amount to a violation of the law on the part of the association.

This view is also supported by one case.<sup>50</sup> The court's charge to the jury in that case stated:

It is not unlawful under the antitrust acts for a Capper-Volstead cooperative, such as the National Cranberry Association admittedly is, to try to acquire even 100 percent of the market if it does it exclusively through marketing agreements approved under the Capper-Volstead Act. \* \* \*

It has been argued that a contrary view is probably supported by another case,<sup>51</sup> which construed a marketing cooperative exemption under the Fishermen's Collective Marketing Act<sup>52</sup> comparable to Capper-Volstead and administered by the Secretary of the Interior. There a canner sought an injunction against a fishermen's cooperative for requiring the canner to purchase exclusively from cooperative members. The cooperative's extensive control of the fish catch in the adjacent seaports forced canners to accept such terms or go out of business. Although there was no combination with outsiders, the court affirmed an injunction on the authority of the *Borden* case discussed below.<sup>53</sup>

It should be remembered that the Capper-Volstead Act was passed subsequent to the antitrust statutes and insofar as there is any conflict it should control. An association that meets the conditions of the Capper-Volstead Act is not free to engage in any course of conduct which it might see fit to adopt. For instance, if it should engage in unfair competition, that would subject it to the jurisdiction conferred upon the Federal Trade Commission by the act<sup>54</sup> creating it. Again, abnormal conduct on the part of an association might subject it to the jurisdiction of the Department of Justice of the United States for a violation of the antitrust laws.

So far as the price at which an association offers its products for sale is concerned, its reasonableness, if a question with reference thereto should arise, is to be determined by the Secretary of Agriculture. If he "shall have reason to believe that any such association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced thereby," he may, following a hearing, issue an order directing such association to cease and desist from monopolization or restraint of trade.

This act has no application to purely purchasing associations or to cooperative stores, or associations engaged in rendering farm business services,

<sup>50</sup> *Cape Cod Food Products v. National Cranberry Association*, 119 F. Supp. 900, 907. See also *United States v. Dairy Coop. Association*, 49 F. Supp. 475.

<sup>51</sup> *Hinton v. Columbia River Packers Association*, 131 F. 2d 88.

<sup>52</sup> 48 Stat. 1213; 15 U. S. C. A. 521.

<sup>53</sup> *Borden* has been cited in two other fishermen's cooperative cases, *Manaka v. Monterey Sardine Industries, Inc.*, 41 F. Supp. 531, where the plaintiff prevailed in a treble damage suit for violation of the Sherman Act and *Local 36 of International Fishermen and Allied Workers of America v. United States*, 177 F. 2d 320, cert. den. 339 U. S. 947, a criminal conviction under the Sherman Act upheld on the strength of the *Columbia River* and *Borden* cases.

<sup>54</sup> 38 Stat. 730, 15 U. S. C. A. 12. Several complaints have been brought against cooperatives by the Federal Trade Commission. For example, see *Carpel Frosted Foods, Inc.*, FTC Order No. 5482; *Florida Citrus Mutual*, FTC Doc. No. 6074; *C. H. Musselman Co., et al.*, FTC Doc. No. 6041.

for the reason that it relates only to associations that are composed of farmers, planters, ranchmen, dairymen, nut or fruit growers who are engaged in collectively processing, preparing for marketing, handling, and marketing in interstate and foreign commerce the products of persons so engaged, and then only with such associations as have complied with the conditions of the statute.

The question of whether an association is liable for income taxes is one that is not resolved by this act. Whether an association is liable for income taxes is to be determined by the income-tax statutes and the regulations issued under them.

The Capper-Volstead Act in no way attempts to "restrict or stifle production."<sup>55</sup>

This act does not provide for the incorporation of cooperatives and it makes no provision for their formation. Those interested in organizing or incorporating such associations should look to the laws of their respective States relating thereto.

Congress, under the Constitution, has control over interstate and foreign commerce, and this act deals only with the operations of associations in such commerce, and then only with such associations as comply with certain conditions prescribed therein. The test which those interested in an association should apply to learn if their association comes within the scope of the act is: Does the association meet the conditions set forth therein? These conditions are as follows:

A. "That persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged."

This and other language which appears in the act make it plain that a cooperative, to come within the act, must be composed of producers. Probably, in those isolated instances in which nonproducers become members of an association through inheritance or otherwise by operation of law contrary to the policy of the association, or in which producers cease to be such, the association being one which is incontrovertibly controlled and dominated by its producer members, would not, because of such nonproducer members, if it otherwise complied with the terms of the act, fall without its provisions. Such association should take such measures as are compatible with law to eliminate and exclude voting nonproducers from membership. This is true, whether it is incorporated or unincorporated, and whether it is organized with or without capital stock.

B. Associations that desire to come within the act must be operated for the mutual benefit of the members thereof, as such producers, and conform to one or both of the following requirements: "First, that no member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein, or, second, that the association does not pay dividends on stock or membership capital in excess of 8 per centum per annum. And in any case to the following: Third, that the association shall not deal in products of nonmembers to an amount greater in value than such as are handled by it for members."

Associations must comply with either the first or second conditions and may comply with both. As the first condition embodies the one-man one-vote principle, associations operating on this basis, or which elect to operate

<sup>55</sup> Keegan, M. J. POWER OF AGRICULTURAL COOPERATIVE ASSOCIATIONS TO LIMIT PRODUCTION. 26 Mich. L. Rev. 648-673 (1928).



on this basis, need not, unless they wish to do so, give consideration to the second condition. Of course, an association, if it desires, may operate in accordance with both of these conditions, but it will come within the scope of the act by complying with only one of them, if it complies with the other conditions of the act.

If an association elects to operate under the second condition, dividends on stock or membership capital are limited to 8 percent per annum. This does not mean that voting stock may be owned by or sold to nonproducers so far as this act is concerned. Only associations whose voting stock is held by or whose membership is made up of producers can come within the act. It is not necessary for associations that operate under the act to pay dividends in any amount unless they elect to do so. It is entirely a matter of choice with them. If, however, an association elects to operate under the second condition, dividends, if paid, must not exceed 8 percent per annum.

All associations that wish to operate under the act must meet the third condition, which is that the value of the products handled for nonmembers shall not exceed the value of those handled for members. This condition does not mean that an association must handle any business for nonmembers. It may do so or not, as it sees fit. If it does handle such business, however, the act specifically provides that the value of the products handled for nonmembers must not exceed the value of the products handled for members.

The act provides that such associations must be "operated for the mutual benefit of the members thereof as such producers." This and other language in the statute means that all commodities handled which are not produced by the members must be regarded as nonmember business. Therefore, commodities purchased by members and delivered to an association constitute nonmember business. In this connection, the Committee on the Judiciary of the Senate which had the bill in charge, in its report thereon said:

The bill before us during the last session authorized the organization of associations dealing in "products of their members." The bill now under consideration authorizes them to deal in the "products of persons so engaged." Obviously, under the former the associations would be restricted in their dealings to members; in the latter, though they are restricted as to the character of the products in which they may deal, it is clear that they may deal with any person in such products, whether he be a member or not.

The bill has for its purpose the removal of obstacles, if such there be in the Federal statutes, in the way of the organization of cooperative farm marketing associations, a purpose with which the majority, at least, of your committee is in full sympathy. It may be, and probably is, true that such associations cannot operate with the highest degree of success, or with that degree of success which your committee would be glad to see attend their efforts, unless they are permitted to deal to some extent in the products of nonmembers similar in character to those handled for the members. But the protection of the statute ought not to be given to a small number of persons of the classes named in the bill who contribute from their own farms an inconsiderable quantity of the product handled by the association.<sup>66</sup>

Under section 2 of the act it is the duty of the Secretary of Agriculture, if he believes that any association operating under it monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced by reason of such monopoly or restraint of trade, to serve upon such association a complaint with respect to such matters, requiring the association to show cause why an order should not be issued directing it to cease and desist from monopolization or restraint

<sup>66</sup> 62 Cong. Rec. 2121 (1922).

of trade. After a hearing, if the Secretary of Agriculture believes that such an association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced thereby, the act provides that he shall issue an order reciting the facts found by him and directing such association to cease and desist from monopolization or restraint of trade. If such order is not complied with by the association within 30 days, the Secretary of Agriculture is then required to file a certified copy of the order issued by him, together with certified copies of all records in the matter, in the district court of the United States in the judicial district in which such association has its principal place of business. The Department of Justice has charge, under the act, of the enforcement of such order. The district court of the United States is given jurisdiction to affirm, modify, or set aside the order or to enter such other decree as it may deem equitable.

In this connection, it will be remembered that the Capper-Volstead Act permits an association meeting its conditions to have a complete monopoly in the handling and the marketing of the agricultural products with which it is concerned, and if this monopoly is obtained by proper means, it is consistent with law. Like any other business entity not engaged in the operation of a public utility or business whose rates are fixed by law, it may determine the prices at which it may offer its goods for sale. As a result, the only agency that is authorized to proceed against an association on account of undue enhancement alone is the Secretary of Agriculture, and his authority to do so is specifically conferred by statute.<sup>57</sup> Moreover, the conferring of this specific authority on the Secretary of Agriculture is a denial of the existence of such authority in other agencies.<sup>58</sup>

The fact that a cooperative may have unduly enhanced the prices of the agricultural products which it is engaged in marketing gives the Secretary of Agriculture jurisdiction to proceed against the association, and because the Secretary of Agriculture is specifically given this jurisdiction, the question of whether there has been an undue enhancement of prices is a matter for his exclusive determination.

As stated above, associations meeting the conditions of the Capper-Volstead Act may have a common marketing agency, but they may not, nor may such a common marketing agency, enter into abnormal transactions such as price fixing or other agreements with third persons which are contrary to the antitrust statutes. If an association enters into such agreements or transactions which amount to a violation of the antitrust statutes, it is amenable thereto and the Department of Justice may proceed against it.<sup>59</sup>

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<sup>57</sup> *Tobacco Growers' Coop. Association v. Jones*, 185 N. C. 265, 117 S. E. 174, 33 A. L. R. 231.

<sup>58</sup> "That remedy is in the Secretary of Agriculture exclusively. If he does not move, absolutely nobody can move, and the bill does not give the individual, it does not give any association, any right to go into court and have these prices reviewed." Mr. Husted, 59 Cong. Rec. 8021 (1920). Cf. *Silberschein v. United States*, 266 U. S. 221, 45 S. Ct. 69, 69 L. Ed. 256, and *Mara v. United States*, 54 F. 2d 397.

<sup>59</sup> *United States v. Borden Company*, 308 U. S. 188, 204, 60 S. Ct. 182, 84 L. Ed. 181, reversing 28 F. Supp. 177. See also *United States v. Hutcheson*, 312 U. S. 219, 61 S. Ct. 463, 85 L. Ed. 788. In *United States v. Maryland Cooperative Milk Producers, Inc., and Maryland and Virginia Milk Producers Association, Inc.*, U. S. D. C. for D. C., 145 F. Supp. 151, decided October 16, 1956, the defendants, each of which is an association of producers of milk, were indicted for conducting an unlawful combination and conspiracy to fix prices for milk sold to distributors, which in turn was supplied the Government. A motion for judgment of acquittal on the grounds that their conduct was exempt under section 6 of the Clayton Act and the Capper-Volstead Act was granted. The district judge said: "\* \* \* a combination

On the other hand, as an independent organization an association meeting the terms of the Capper-Volstead Act, or a common marketing agency composed of such associations, has all the general rights, powers and privileges that a businessman or commercial corporation possesses. For instance, as businessmen and business corporations may select their customers, an association of farmers may likewise do so.<sup>60</sup> Again a cooperative, like any other organization, has the right to select its members.<sup>61</sup>

In connection with the right of associations to select their own members, it will be remembered that this, in essence, means that they may determine the producers from whom they will receive agricultural products for handling and marketing. It is a common right of businessmen and corporations to determine the parties from whom they will purchase goods, and a cooperative in determining who may become members thereof is simply determining from whom it will acquire commodities. Again, no reason is apparent why an association may not enter into an agreement to furnish a dealer with all of a given commodity that his business may require.<sup>62</sup>

In a New York case nonunion workers were denied the right to enjoin the carrying out of a closed shop contract entered into by their employer with a labor union which compelled these workers to become members of the union if they were to continue their employment.<sup>63</sup>

It is interesting that the court in upholding the right of the labor union to enter into a closed shop agreement, said:

As before stated, there is nothing in the present case before us to indicate that any injury was sought or intended to the plaintiffs or nonunion members, but that the object of the contract and of the action of the defendant labor union is to advance its own interests and ability of its members through the closed shop, to meet on even terms their employers in present or future negotiations.<sup>64</sup>

May a cooperative prescribe resale prices for commodities which it sells?

Generally, in the absence of a statutory authorization, agreements of this character are invalid.<sup>65</sup>

On the other hand, it appears to be established that a seller may refuse

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between two or more agricultural cooperatives to fix prices of their products is exempt from the antitrust laws provided no other person that is not of such an organization or a member of such a group is a part of the combination."

<sup>60</sup> *Federal Trade Commission v. Raymond Brothers-Clark Co.*, 263 U. S. 565, 44 S. Ct. 162, 68 L. Ed. 448, 30 A. L. R. 1114.

<sup>61</sup> See *Who May Become Members*, p. 5. Cf. *Associated Press v. United States*, 326 U. S. 1, 65 S. Ct. 1416, 89 L. Ed. 2013.

<sup>62</sup> *Federal Trade Commission v. Curtis Publishing Company*, 260 U. S. 568, 43 S. Ct. 210, 67 L. Ed. 408; *Arkansas Brokerage Co. v. Dunn & Powell Inc.*, 173 F. 899, 35 L. R. A. (N. S.) 464; *Barnes v. Dairymen's League Coop. Association*, 222 N. Y. S. 294, 220 App. Div. 624; *Wiseman v. Dennis*, 156 Va. 431, 157 S. E. 716; *Castorland Milk & Cheese Company v. Shantz*, 179 N. Y. S. 131; *American Fur Manufacturers Association v. Associated Fur Coat and Trimming Manufacturers*, 291 N. Y. S. 610, 161 Misc. 246; *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 147 Ore. 503, 30 P. 2d 344; *Stark County Milk Producers' Association v. Tabeing*, 129 Ohio St. 159, 194 N. E. 16, 98 A. L. R. 1393; *Cole Motor Car Company v. Hurst*, 228 F. 280; *American Sea Green Slate Company v. O'Halloran*, 229 F. 77; *Virtue v. Creamery Package Manufacturing Company*, 227 U. S. 8, 33 S. Ct. 202, 57 L. Ed. 393, affirming 179 F. 115, 102 C. C. A. 413; *Fletcher Cyclopedic Corporations*, Perm. Ed., vol. 10, sec. 5010, p. 836; 3 Williston on CONTRACTS, p. 2896. Ballantine, W. COOPERATIVE MARKETING ASSOCIATIONS. 8 Minn. L. Rev. 1-27 (1923).

<sup>63</sup> *Williams v. Quill*, 277 N. Y. 1, 12 N. E. 2d 547, appeal dismissed, 303 U. S. 621, 58 S. Ct. 650, 82 L. Ed. 1085. See also Mills, David N., LABOR LAW—RIGHT OF UNION TO DENY MEMBERSHIP TO APPLICANT. 40 Mich. L. Rev. 2-310 (1941).

<sup>64</sup> *Williams v. Quill*, 277 N. Y. 1, 12 N. E. 2d 547, appeal dismissed, 303 U. S. 621, 58 S. Ct. 650, 82 L. Ed. 1085.

<sup>65</sup> *Miles Medical Company v. Park & Sons Company*, 220 U. S. 373, 31 S. Ct. 376, 55 L. Ed. 502.



to deal with those who do not adhere to the schedule of resale prices prescribed by him and that a seller may announce that he may refuse to deal with those who do not adhere to such a price schedule.

In a certain case <sup>66</sup> the Supreme Court said:

By these decisions <sup>67</sup> it is settled that in prosecutions under the Sherman Act a trader is not guilty of violating its terms who simply refuses to sell to others, and he may withhold his goods from those who will not sell them at the prices which he fixes for their resale. He may not, consistently with the act, go beyond the exercise of this right, and by contracts or combinations, express or implied, unduly hinder or obstruct the free and natural flow of commerce in the channels of interstate trade.

It is believed that the restrictions of the foregoing statement are as applicable to a cooperative as to any other type of business concern; and that a cooperative may prescribe resale prices only under conditions in which any other business concern could do likewise. <sup>68</sup>

Agricultural associations, especially in the case of milk, frequently enter into contracts agreeing to furnish distributors with all the milk which they may need during a given period. One case involving this type of situation has been before the courts. <sup>69</sup> The Maryland and Virginia Milk Producers Association, which controlled a large percentage of the milk in the District of Columbia metropolitan area, entered into full-supply contracts with some of the major milk distributors. As a defense to indictment under section 3 of the Sherman Act, the Capper-Volstead Act's provisions were invoked. The indictment was first dismissed but the Court of Appeals reinstated it, apparently relying on a charge of concerted action between the cooperative and outsiders. On a second appeal the Court of Appeals reversed conviction of the defendants for failure to show that the agreements were made for the purpose of eliminating competition from independent sources of supply. This decision appears to make permissible a marketing cooperative's sales contracts which require purchasers to obtain their full supply from the association, where the contracts are reasonably ancillary to effectuation of the cooperative's legitimate marketing objectives.

However, under other circumstances the Supreme Court of the United States has considered full-supply contracts to be in violation of the anti-trust laws. <sup>70</sup> Accordingly, no full-supply or exclusive contract should be entered into without full consideration of the question whether a violation of the antitrust laws would result.

In general, as long as an association is acting alone and on its own initiative, it is believed that it has the same latitude in the conduct of its business that is possessed by any businessman, and that third persons may deal with an association accordingly. <sup>71</sup>

On the other hand, it must not be assumed that the Capper-Volstead Act confers rights or privileges on associations that meet its conditions,

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<sup>66</sup> *Federal Trade Commission v. Beech-Nut Packing Company*, 257 U. S. 441, 42 S. Ct. 150, 66 L. Ed. 307, 19 A. L. R. 882.

<sup>67</sup> *United States v. Colgate & Company*, 250 U. S. 300, 39 S. Ct. 465, 63 L. Ed. 992, 7 A. L. R. 433; *Frey & Son, Inc. v. Cudahy Packing Company*, 256 U. S. 208, 41 S. Ct. 451, 65 L. Ed. 892; *United States v. Schrader's Son, Inc.*, 252 U. S. 85, 40 S. Ct. 251, 64 L. Ed. 471.

<sup>68</sup> See *Ethyl Gasoline Corporation v. United States*, 309 U. S. 436, 60 S. Ct. 618, 84 L. Ed. 852; *Biddle Purchasing Company v. Federal Trade Commission*, 96 F. 2d 687; *Armand Company v. Federal Trade Commission*, 78 F. 2d 707.

<sup>69</sup> *United States v. Maryland & Virginia Milk Producers' Association, Inc.*, 179 F. 2d 426, 193 F. 2d 907.

<sup>70</sup> *Standard Oil Co. of California v. United States*, 337 U. S. 293, 69 S. Ct. 1051, 93 L. Ed. 1371; *Federal Trade Commission v. Motion Picture Advertising Service Co., Inc.*, 344 U. S. 392, 73 S. Ct. 361, 97 L. Ed. 426.

<sup>71</sup> 61 Cong. Rec. 1033 (1921).

which are not possessed by other entities. If such associations enter into conspiracies or combinations with third persons they are as amenable to prosecution under the antitrust laws as any other organizations. This is made clear by the following quotations from an opinion of the Supreme Court of the United States in the Borden case: <sup>72</sup>

\* \* \* We cannot find in the Capper-Volstead Act \* \* \* an intention to declare immunity for the combinations and conspiracies charged in the present indictment. Section 6 of the Clayton Act, enacted in 1914, had authorized the formation and operation of agricultural organizations provided they did not have capital stock or were not conducted for profit, and it was there provided that the antitrust laws should not be construed to forbid members of such organizations "from lawfully carrying out the legitimate objects thereof." They were not to be held illegal combinations. The Capper-Volstead Act, enacted in 1922, was made applicable as well to cooperatives having capital stock. The persons to whom the Capper-Volstead Act applies are defined in Section one as producers of agricultural products, "as farmers, planters, ranchmen, dairymen, nut or fruit growers." They are authorized to act together "in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce" their products. They may have "marketing agencies in common," and they may make "the necessary contracts and agreements to effect such purposes."

The right of these agricultural producers thus to unite in preparing for market and in marketing their products, and to make the contracts which are necessary for that collaboration, cannot be deemed to authorize any combination or conspiracy with others persons in restraint of trade that these producers may see fit to devise. In this instance, the conspiracy charged is not that of merely forming a collective association of producers to market their products but a conspiracy, or conspiracies, with major distributors and their allied groups, with labor officials, municipal officials, and others, in order to maintain artificial and non-competitive prices to be paid to all producers for all fluid milk produced in Illinois and neighboring States and marketed in the Chicago area, and thus in effect, as the indictment is construed by the court below, "to compel independent distributors to exact a like price from their customers" and also control "the supply of fluid milk permitted to be brought to Chicago." 28 F. Supp. at pages 180-182. Such a combined attempt of all the defendants, producers, distributors and their allies, to control the market finds no justification in Section one of the Capper-Volstead Act.

Nor does the court below derive its limitation of the Sherman Act from Section one. The pith of the court's conclusion is that under Section two an exclusive jurisdiction with respect to the described cooperative associations is vested, in the first instance, in the Secretary of Agriculture, and that, until the Secretary acts, the judicial power to entertain a prosecution under the Sherman Act cannot be invoked. Section two of the Capper-Volstead Act does provide a special procedure in a case where the Secretary of Agriculture has reason to believe that any such association "monopolizes" or restrains interstate trade "to such an extent that the price of any agricultural product is unduly enhanced." Thereupon the Secretary is to serve upon the association a complaint, stating his charge with notice of hearing. And if upon such hearing the Secretary is of the opinion that the association "monopolizes" or does restrain interstate trade to the extent above mentioned, he then is to issue an order directing the association "to cease and desist" therefrom. Provision is made for judicial review.

We find no ground for saying that this limited procedure is a substitute for the provisions of the Sherman Act, or has the result of permitting the sort of combinations and conspiracies here charged unless or until the Secretary of Agriculture takes action. That this provision of the Capper-Volstead Act does not cover the entire field of the Sherman Act is sufficiently clear. The Sherman Act authorizes criminal prosecutions and penalties. The Capper-Volstead Act provides only for a civil proceeding. The Sherman Act hits at attempts to monopolize as well as actual monopolization. And Section two of the Capper-Volstead Act contains no provision giving immunity from the Sherman Act in the absence of a proceeding by the Secretary. We think that the procedure under Section two of the Capper-

<sup>72</sup> *United States v. Borden Company*, 308 U. S. 188, 60 S. Ct. 182, 84 L. Ed. 181, reversing 28 F. Supp. 177. See also *Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Association*, 276 U. S. 71, 48 S. Ct. 291, 72 L. Ed. 473; affirming 208 Ky. 643, 271 S. W. 695; *Farmers' Livestock Commission Company v. United States*, 54 F. 2d 375; *Board of Trade of City of Chicago v. Wallace*, 67 F. 2d 402; *United States v. Dried Fruit Association of California*, 4 F. R. D. 1.

Volstead Act is auxiliary and was intended merely as a qualification of the authorization given to cooperative agricultural producers by Section one, so that if the collective action of such producers, as there permitted, results in the opinion of the Secretary in monopolization or unduly enhanced prices, he may intervene and seek to control the action thus taken under Section one. But as Section one cannot be regarded as authorizing the sort of conspiracies between producers and others that are charged in this indictment, the qualifying procedure for which Section two provides is not to be deemed to be designed to take the place of, or to postpone or prevent, prosecution under Section one of the Sherman Act for the purpose of punishing such conspiracies.

It is significant that the Supreme Court in the opinion in the Borden case said that orders or agreements entered into by the Secretary of Agriculture pursuant to the Agricultural Marketing Agreement Act "would, of course, be a defense to the prosecution under the Sherman Act to the extent that the prosecution sought to penalize what was thus validly agreed upon or directed by the Secretary."

It is submitted that the opinion in the case from which the foregoing quotations are taken may, therefore, be regarded as establishing the constitutionality of the Capper-Volstead Act.

The Grain Futures Act provides that associations of producers meeting certain terms and conditions may be admitted to membership on boards of trade, subject to that act, but does not define what shall constitute such a cooperative. An association was denied membership on the Chicago Board of Trade Clearing Corporation and instituted proceedings for the purpose of obtaining membership. The commission provided for by the Grain Futures Act suspended the Board of Trade of the City of Chicago because it refused to admit the cooperative to membership in the Board of Trade Clearing Corporation and the Board of Trade then appealed. The court held that the Capper-Volstead Act should be used as a guide in determining if the cooperative was a cooperative from the standpoint of the Grain Futures Act; and also that if upon further consideration by the commission, necessitated by the insufficiency of the evidence, it was found that the cooperative had done more business with nonmembers than with members, it would not be entitled to membership in the Board of Trade Clearing Corporation.<sup>73</sup> Among other things the court said:

The Capper-Volstead Act, which authorized cooperative associations, was to that extent in derogation of the antitrust laws; and it was clearly the intent of Congress, in adopting the act, to guard against creation thereunder of combinations that might tend to monopoly beyond the extent authorized by the Capper-Volstead Act.

In the case just cited, which involved the Farmers' Livestock Commission Co., it was held that the act authorizes associations to have marketing agencies in common. In this connection the following is taken from an opinion of the Attorney General of the United States:

This language fairly imports that such producers, for such purposes, may cooperate through any organization, incorporated or unincorporated, for the accomplishment of the purposes stated, so long as the only persons interested in the organization are producers, and its operations are conducted solely for their mutual benefit. The statute imposes no restriction upon the business forms of cooperation and association which may be employed to effectively organize cooperative associations of agricultural producers for handling and marketing their products. Obviously, it is convenient, if not indeed necessary, to any effective cooperative association, that local associations should act through centralized marketing agencies in disposing of the products of their members, and that they should, in representation of their members, hold stock in such centralized marketing agencies; I cannot doubt, in view of the purpose of the Capper-Volstead Act, that such methods of cooperation and association between

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<sup>73</sup> *Board of Trade of City of Chicago v. Wallace*, 67 F. 2d 402, 408. —



agricultural producers were intended to be authorized under the very broad language of this statute.<sup>74</sup>

In view of the interpretation placed upon the antitrust statutes by the Supreme Court of the United States in several cases, it is arguable that the Capper-Volstead Act was not, strictly speaking, required for the purpose of giving authority to farmers to form associations, but that the organization of cooperative associations was permissible under the antitrust statutes. In a case involving the right of independent producers of coal to act together in the marketing of coal, the Supreme Court said:

We agree that there is no ground for holding defendants' plan illegal merely because they have not integrated their properties and have chosen to maintain their independent plants, seeking not to limit but rather to facilitate production. We know of no public policy, and none is suggested by the terms of the Sherman Act, that, in order to comply with the law, those engaged in industry should be driven to unify their properties and businesses, in order to correct abuses which may be corrected by less drastic measures. Public policy might indeed be deemed to point in a different direction. If the mere size of a single, embracing entity is not enough to bring a combination in corporate form within the statutory inhibition, the mere number and extent of the production of those engaged in a cooperative endeavor to remedy evils which may exist in an industry, and to improve competitive conditions, should not be regarded as producing illegality. The argument that integration may be considered a normal expansion of business, while a combination of independent producers in a common selling agency should be treated as abnormal—that one is a legitimate enterprise and the other is not—makes but an artificial distinction. The Anti-Trust Act aims at substance. Nothing in theory or experience indicates that the selection of a common selling agency to represent a number of producers should be deemed to be more abnormal than the formation of a huge corporation bringing various independent units into one ownership.<sup>75</sup>

### Classification of Agriculture

The provisions of the Capper-Volstead Act, excepting producers' associations from the antitrust laws to the extent heretofore indicated, appear to be founded on a real distinction and to be entirely reasonable. Agriculture is fundamentally different from industry. The number engaged in agriculture or any branch thereof, the distances which separate them, the conditions incident to the production of agricultural products, the inherent difficulties involved in controlling acreage, the variability of production from climatic causes—the caprice of the seasons, and the number of agricultural products that may be substituted for each other seem to afford reasonable bases for classification. Other instances of classification appear to have no more justification. For instance, the Federal Trade Commission Act<sup>76</sup> condemns unfair competition by those engaged in interstate or foreign commerce, but banks are specifically excepted from

<sup>74</sup> 36 Ops. Att'y Gen. 326, 339.

<sup>75</sup> *Appalachian Coals, Inc. v. United States*, 288 U. S. 344, 376, 53 S. Ct. 471, 77 L. Ed. 825. See also *Filene's Sons Co. v. Fashion Originators' Guild of America, Inc.*, 14 F. Supp. 353; *Spielman Motor Sales Co., Inc. v. Dodge*, 8 F. Supp. 437; *Indiana Farmer's Guide Publishing Co. v. Prairie Farmer Publishing Co.*, 70 F. 2d 3, reversed in 293 U. S. 268, 55 S. Ct. 182, 79 L. Ed. 356. As to the "rule of reason" mentioned in *Appalachian Coals, Inc.*, see *Standard Oil Co. of New Jersey v. United States*, 221 U. S. 1, 31 S. Ct. 502, 55 L. Ed. 619, 34 L. R. A. (N. S.) 834, Ann. Cas. 1912D 734; *United States v. American Tobacco Co.*, 221 U. S. 106, 31 S. Ct. 632, 55 L. Ed. 663; *United States v. United States Steel Corporation*, 251 U. S. 417, 40 S. Ct. 293, 64 L. Ed. 343, 8 A. L. R. 1121; *Board of Trade of the City of Chicago v. United States*, 246 U. S. 231, 38 S. Ct. 242, 62 L. Ed. 683; *National Association of Window Glass Manufacturers v. United States*, 263 U. S. 403, 44 S. Ct. 148, 68 L. Ed. 358. See also, THE RULE OF REASON IN LOOSE-KNIT COMBINATION, 32 Colum. L. Rev. 291 (1932).

<sup>76</sup> 38 Stat. 717; 15 U. S. C. A. 41 *et seq.*

the provisions of that act which has been repeatedly upheld by the Supreme Court of the United States.<sup>77</sup>

Moreover, insofar as the Capper-Volstead Act is concerned, it is not clear that there is any clause in the Federal Constitution which that act could be said to violate. Cases like the *Connolly case*<sup>78</sup> have no bearing on the constitutionality of the Capper-Volstead Act because they are based on the equal-protection clause of the Federal Constitution, which clause by its own terms is restricted to State action only and has no bearing on Federal legislation as the Supreme Court of the United States has held.<sup>79</sup> Moreover, the *Connolly case* has now been overruled.<sup>80</sup> It is true that two Federal district courts, without referring to any provision of the Constitution, held that the exemption of farmers contained in the war measure known as the Food Control Act<sup>81</sup> was unconstitutional,<sup>82</sup> but a Federal circuit court of appeals held the exemption valid.<sup>83</sup>

State legislation which provides specifically for the peculiar needs of farmers or producers under the decisions of the Supreme Court of the United States is founded on a reasonable basis of classification, and on this theory the Bingham Cooperative Marketing Act of Kentucky,<sup>84</sup> which by its terms was restricted to producers, was upheld by the Supreme Court.<sup>85</sup> A statute of Louisiana which imposed a license tax upon persons and corporations carrying on the business of refining sugar and molasses was upheld although "planters and farmers grinding and refining their own sugar and molasses" were excepted therefrom.<sup>86</sup>

The California Agricultural Prorate Act, which authorizes the establishment by State officials of programs for the marketing of agricultural commodities produced in the State, was held valid and not violative of the Sherman Act, the Agricultural Marketing Agreement Act of 1937, or the commerce clause of the Constitution.<sup>87</sup>

An order issued by the Secretary of Agriculture under the Agricultural Marketing Agreement Act of 1937, which operated to relieve cooperatives from a requirement to pay a uniform price for milk, was upheld against the contention that it was unreasonably discriminatory and violated the "due process" clause of the fifth amendment.<sup>88</sup>

A case decided by the Supreme Court of the United States draws a distinction between the cooperative type of business and the commercial type

<sup>77</sup> *Federal Trade Commission v. Gratz, Copartners*, 253 U. S. 421, 40 S. Ct. 572, 64 L. Ed. 993; *Federal Trade Commission v. Winsted Hosiery Co.*, 258 U. S. 483, 42 S. Ct. 384, 66 L. Ed. 729.

<sup>78</sup> *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 540, 22 S. Ct. 431, 46 L. Ed. 679; *In re Grice*, 79 F. 627, 169 U. S. 284, 18 S. Ct. 323, 42 L. Ed. 748; *Beatrice Creamery Co. v. Cline*, 9 F. 2d 176, modified in *Cline v. Frink Dairy Co.*, 274 U. S. 445, 47 S. Ct. 681, 71 L. Ed. 1146.

<sup>79</sup> *Truax v. Corrigan*, 257 U. S. 312, 340, 42 S. Ct. 124, 66 L. Ed. 254, 27 A. L. R. 375.

<sup>80</sup> *Tigner v. Texas*, 310 U. S. 141, 60 S. Ct. 879, 84 L. Ed. 1124, 130 A. L. R. 1321. See Annotation LEGALITY OF COMBINATION AMONG FARMERS, 130 A. L. R. 1326.

<sup>81</sup> 40 Stat. 276.

<sup>82</sup> *United States v. Armstrong*, 265 F. 683; *United States v. Yount*, 267 F. 861.

<sup>83</sup> *Weed & Co. v. Lockwood*, 266 F. 785.

<sup>84</sup> See p. 301 of Appendix.

<sup>85</sup> *Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Association*, 276 U. S. 71, 48 S. Ct. 291, 72 L. Ed. 473, affirming, 208 Ky. 643, 271 S. W. 695. See also Regulatory Statutes, p. 251.

<sup>86</sup> *American Sugar Refining Co. v. Louisiana*, 179 U. S. 89, 21 S. Ct. 43, 45 L. Ed. 102.

<sup>87</sup> *Parker v. Brown*, 317 U. S. 341, 63 S. Ct. 307, 87 L. Ed. 315.

<sup>88</sup> *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, 59 S. Ct. 993, 83 L. Ed. 1446. See also *Hood & Sons, Inc. v. United States*, 307 U. S. 588, 59 S. Ct. 1019, 83 L. Ed. 1478.

of business.<sup>80</sup> In this case an Oklahoma statute, declaring all cotton gins in that State public utilities and providing that no gin for the public ginning of cotton could be established unless the corporation commission of the State found that public necessity therefor existed, was involved. This statute contains an exception providing that if 100 citizens and taxpayers in the community where it is proposed to establish a cotton gin present a petition showing that the gin is to be run cooperatively, the corporation commission "shall issue a license for said gin without any further showing."

The operator of a commercial gin that would have been adversely affected by the establishment of a cooperative gin brought suit against the corporation commission and the Durant Cooperative Ginning Co., to enjoin the commission from issuing a license to that company. The court referred to two cooperative acts of Oklahoma, one enacted in 1917 and the other in 1919, and with reference to these two acts said:

It is important to bear in mind that the Durant Company was not organized under the act of 1917, but under that of 1919. The former authorizes the formation of an association for mutual help, without capital stock, not conducted for profit, and restricted to the business of its own members, except that it may act as agent to sell farm products and buy farm supplies for a nonmember, but as a condition may impose upon him a liability, not exceeding that of a member, for the contracts, debts and engagements of the association, such services to be performed at the actual cost thereof including a pro rata part of the overhead expenses. (Comp. Stats. 1921, sec. 5608.) Under this exception, the difference between a nonmember and a member is not of such significance or the authority conferred of such scope as to have any material effect upon the general purposes or character of the corporation as a mutual association. As applied to corporations organized under the 1917 act, we have no reason to doubt that the classification created by the proviso might properly be upheld. (*American Sugar Refining Co. v. Louisiana*, 179 U. S. 89, 21 S. Ct. 43, 45 L. Ed. 102; *Warehouse Co. v. Tobacco Growers*, 276 U. S. 71, 48 S. Ct. 291, 72 L. Ed. 473.) A corporation organized under the act of 1919, however, has capital stock, which, up to a certain amount, may be subscribed for by any person, firm, or corporation; is allowed to do business for others; to make profits and declare dividends, not exceeding 8 percent per annum; and to apportion the remainder of its earnings among its members ratably upon the amount of products sold by them to the corporation. Such a corporation is in no sense a mutual association. Like its individual competitor, it does business with the general public for the sole purpose of making money. Its members need not even be cotton growers. They may be—all or any of them—bankers or merchants or capitalists having no interest in the business differing in any respect from that of the members of an ordinary corporation. The differences relied upon to justify the classification are, for that purpose, without substance. The provision for paying a portion of the profits to members or, if so determined, to nonmembers, based upon the amounts of their sales to or purchases from the corporation, is a device which, without special statutory authority, may be and often is resorted to by ordinary corporations for the purpose of securing business. As a basis for the classification attempted, it lacks both relevancy and substance.

The Supreme Court held the exception in the Oklahoma statute in question unconstitutional on the ground that the method of doing business, which the cooperative gin in question was authorized to follow by the statute under which it was organized, was so similar to that which was followed by commercial gins that there was no sound difference between the two. The court said: "Like its individual competitor, it does business with the general public for the sole purpose of making money." It is submitted that this language reveals the real reason why the court held the exception to the Oklahoma statute unconstitutional. The court distinctly pointed out that cooperative corporations formed under the 1917 act, under which members and nonmembers must be treated alike, and which function on a nonprofit basis, were so different from commercial concerns as to entitle them to a distinct classification; and if the so-called cooperative corporation

<sup>80</sup> *Frost v. Corporation Commission of Oklahoma*, 278 U. S. 515, 523, 49 S. Ct. 235, 73 L. Ed. 483, reversing 26 F. 2d 508.



involved had been formed under the 1917 act, the court indicates it would have held the exception to the Oklahoma statute constitutional. Obviously, there is a broad distinction between the cooperative type of business and the commercial type of business.<sup>90</sup>

This case should not be regarded as bringing into question any of the cooperative statutes. It involved a licensing act which authorized a commission to deny a license to any applicant therefor other than a cooperative; and the court was of the opinion that the manner of operation of the particular "cooperative" gin in question was not sufficiently different from that of a private gin to justify the granting of a license to the "cooperative" gin without a showing of public necessity therefor. The cooperative statutes usually do not prevent private parties from going into business.

In another case<sup>91</sup> in which a statute of Oklahoma relieved the owner of a cotton gin of the necessity of obtaining a license therefor, if it was to gin cotton only for stockholders of any corporation which might or might not operate on a cooperative basis, it was held that the statute unlawfully discriminated against the operator of a cotton gin who was compelled to obtain a license.

In fields other than agriculture there are many interesting examples of classification. For instance, a statute of Minnesota that fixed the closing hours for barber shops was upheld although the closing hours for other establishments were not fixed.<sup>92</sup> A statute of Mississippi which forbade corporations from operating both cottonseed-oil mills and cotton gins, but which permitted the operation of either by any corporation, was held constitutional.<sup>93</sup> A statute of Kansas which distinguished between farmers' mutual insurance companies and those operated on a commercial basis was also upheld.<sup>94</sup>

The right of employees to form labor unions to bargain collectively and to follow up their demands by orderly strikes is established.<sup>95</sup>

## Promissory Notes

IT IS a practice more or less followed by cooperatives to receive the notes of their members for specified amounts for the purpose of using them as collateral for loans that may be necessary in the conduct of the association's business and for other purposes. The exact nature of such notes depends upon the terms and conditions under which they are given and upon the law of the particular State.<sup>96</sup> For instance, where a resolu-

<sup>90</sup> For a case illustrating this point see *Clinton Coop. Farmers El. Association v. Farmers Union Grain Terminal Association*, 223 Minn. 253, 26 N. W. 2d 117.

<sup>91</sup> *Chickasha Cotton Oil Co. v. Cotton County Gin Co.*, 40 F. 2d 846, 74 A. L. R. 1070.

<sup>92</sup> *Petit v. Minnesota*, 177 U. S. 164, 20 S. Ct. 666, 44 L. Ed. 716.

<sup>93</sup> *Crescent Cotton Oil Co. v. State of Mississippi*, 257 U. S. 129, 42 S. Ct. 42, 66 L. Ed. 166.

<sup>94</sup> *German Alliance Insurance Co. v. Lewis, Superintendent of Insurance of the State of Kansas*, 233 U. S. 389, 34 S. Ct. 612, 58 L. Ed. 1011, L. R. A. 1915C 1189. But see *Hartford Steamboiler Inspection & Insurance Co. v. Harrison*, 301 U. S. 459, 57 S. Ct. 838, 81 L. Ed. 1223.

<sup>95</sup> *Coronado Coal Co. v. United Mine Workers of America*, 268 U. S. 295, 45 S. Ct. 551, 69 L. Ed. 963; *American Steel Foundries v. Tri-City Central Trades Council*, 257 U. S. 184, 209, 42 S. Ct. 72, 66 L. Ed. 189, 27 A. L. R. 360; *Truax v. Corrigan*, 257 U. S. 312, 357, 42 S. Ct. 124, 66 L. Ed. 254, 27 A. L. R. 375; *United States v. Hutcheson*, 312 U. S. 219, 61 S. Ct. 463, 85 L. Ed. 788.

<sup>96</sup> *Farmers' Equity Coop. Association v. Tice*, 122 Kan. 127, 251 P. 421; *Farmers' Coop. Union of Lyons v. Reynolds*, 127 Kan. 16, 272 P. 108; *Elmore v. Maryland & Virginia Milk Producers' Association, Inc.*, 145 Va. 42, 132 S. E. 521, 134 S. E. 472.

tion was adopted at the annual meeting of the stockholders of a cooperative providing that "a \$350 note be signed by each individual stockholder \* \* \* guaranteeing the board of directors against any loss that might occur \* \* \*" it was held that inasmuch as each stockholder had not given a \$350 note, those stockholders who had signed such notes were not liable thereon. "To make the notes obligatory on those who did sign, all should have signed."<sup>97</sup> In another case in which the facts were somewhat similar, a stockholder signed his note for \$350 and failed to show that other stockholders had not executed such notes, so he was held liable when sued thereon.<sup>98</sup>

The bylaws of an association usually set forth the agreement between the association and the members relative to the notes, and this agreement would probably in all cases determine the character of the notes with reference to the association and a member, and whether the association could successfully sue a member on such a note. This would not necessarily be true, however, as will be shown later, in the case of a third person who had received the note of a member from the association.

If the notes executed by the members of an association and delivered to it are accommodation notes—that is, notes executed without consideration and for the purpose of enabling the association to borrow money or obtain credit thereon—then it is settled that the association could not successfully sue a member on such a note. The maker of an accommodation note is known as the accommodation maker. He receives nothing for executing the note and signs it to enable the one in whose favor it is drawn to obtain money or credit from some third party. The fact that a note or other negotiable instrument, no matter what its character, was executed without consideration can always be shown as between the original parties. It furnishes the maker with a complete defense as against the original payee.

If a negotiable note, whether accommodation or otherwise, has been sold, delivered, or transferred before it is due to a third person, in good faith and without notice and for a valuable consideration, the note is enforceable by such third person against the maker without reference to intervening equities. This rule is well established.<sup>99</sup>

However, if an accommodation note is delivered after it is due, although transferred in good faith to a third person and for a valuable consideration, the courts are divided as to whether the maker of the note may plead intervening equities as a defense against the holder.

The general rule, without special regard to accommodation notes, is that one who takes a note or other negotiable instrument after it is due takes it subject to all the equities or defenses that existed between the original parties.<sup>1</sup> For instance, if a note is given without consideration, this could be shown by the maker when sued by one who took the note after it was due.<sup>2</sup>

In the eyes of the law, the fact that the note was not paid when it became due is notice to the party who takes it from the former holder that there is some defect in the paper. However, with respect to accom-

<sup>97</sup> *Farmers' Coop. Union v. Alderman*, 126 Kan. 299, 267 P. 1110.

<sup>98</sup> *Farmers' Coop. Union of Lyons v. Reynolds*, 127 Kan. 16, 272 P. 108. See also *Farmers' Equity Coop. Association v. Tice*, 122 Kan. 127, 251 P. 421; *Makeever v. Barker*, 85 Ind. App. 418, 154 N. E. 692; *Clark v. Pargeter*, 142 Kan. 781, 52 P. 2d 617.

<sup>99</sup> *National Bank of Commerce v. Sancho Packing Co.*, 186 F. 257.

<sup>1</sup> *Otis Elevator Co. v. Ford*, 27 Del. 286, 88 A. 465.

<sup>2</sup> *Hill v. Shields*, 81 N. C. 250, 31 Am. Rep. 499.

modation paper, in view of the fact that it is always given without consideration, the courts in a majority of the States have refused to allow the maker to plead a want of consideration, although the note was taken after it was due.<sup>3</sup> But in some jurisdictions the maker of an accommodation note may successfully plead a want of consideration even as against one who received it in good faith and for a valuable consideration from the original payee.<sup>4</sup>

In a case<sup>5</sup> involving an installment note given by a producer to a cooperative, and assigned by the cooperative as security for a loan after the first installment was overdue, the Supreme Court of California said:

\* \* \* the rule is that a transferee of an installment note is a holder in due course as to the installments to mature in the future when the transfer is made after one or more but not all of the installments are due on its face unless the past due installments have not in fact been paid and he has notice of that fact.

On the facts involved, the court held that the first installment had not been paid and remanded the case for retrial on the issue of notice.

In another case<sup>6</sup> the court, without passing on the question of the negotiability of the note, held that a transferee of a note given by a producer to his cooperative was not a holder in due course. The court pointed out that the transferee, a bank, had knowledge of the association's operations and was aware of a receipt contemporaneously issued for the note. This receipt made it clear that the note was not an unconditional promise to pay but was to be paid by retains from amounts due the maker from the proceeds of his marketed produce.

If a note is payable on demand, the general rule as to ordinary negotiable commercial paper is that one who takes it an unreasonable time after its execution takes it subject to all defenses that existed between the original parties.<sup>7</sup> If the maker would not have a defense to a suit on the note if brought by the original payee, he would not have a defense to a suit instituted by one who took the note from the original payee either before or after maturity. With respect to accommodation paper payable on demand, in those jurisdictions where a want of consideration may be shown by the maker as against one who took such paper after it was due, the maker may successfully plead this defense against one who took the demand accommodation note an unreasonable time after its execution. In a North Dakota case<sup>8</sup> it was said: "It is well established that a note payable on demand is due within a reasonable time after its date, and there are practically no authorities which hold that such a reasonable time can be extended beyond a year."

In a doubtful case it would be a question for the jury to determine whether a note had been sold or delivered as collateral for a loan an unreasonable length of time after its execution. In those States in which the defense of a want of consideration cannot be successfully made by the maker of accommodation paper as against one who took it after it was due, it follows that he could not make it against one who took a demand accommodation note an unreasonable time after its execution.

A note executed by a member of a cooperative and delivered to it, and on which the association could not successfully sue the member, and on

<sup>3</sup> *Naef v. Potter*, 226 Ill. 628, 80 N. E. 1084, 11 L. R. A. (N. S.) 1034.

<sup>4</sup> *Chester v. Dorr*, 41 N. Y. 279; *Peale v. Addicks*, 174 Pa. 543, 549, 34 A. 201.

<sup>5</sup> *Bliss v. California Coop. Producers*, 30 Cal. 2d 240, 181 P. 2d 369.

<sup>6</sup> *Omaha Bank for Cooperatives v. Novotny*, 236 Iowa 54, 17 N. W. 2d 836.

<sup>7</sup> *Otis Elevator Co. v. Ford*, 27 Del. 286, 88 A. 465.

<sup>8</sup> *McAdam v. Grand Forks Mercantile Co.*, 24 N. D. 645, 140 N. W. 725, 47 L. R. A. (N. S.) 246, 251.



which money had not been borrowed or credit obtained, is not a part of the assets of the association. If the association fails or goes into the hands of a receiver, the receiver could not enforce such a note against the member, for he stands in no better position than did the association.<sup>9</sup> On the other hand, if the note is one on which the association could successfully sue, it follows that it is part of the assets of the association, and a receiver would be able to maintain a suit thereon.<sup>10</sup>

In a Michigan case the receiver for a cooperative brought suit on demand notes which were given by 34 members of the association and which were in possession of the association at the time the receiver took charge of its affairs. The notes were given for the purpose of being used as collateral security, and they so specified. Inasmuch as they had not been used for this purpose, the court held that the members were not liable on the notes and that they in no way constituted assets of the association.<sup>11</sup>

If an association borrowed money on its note, giving as collateral security demand notes signed by members of the association, the person who loaned the money, in the event the note evidencing the same was not paid at maturity, would have the right to bring suit on a sufficient number of the demand notes to pay his claim, without his bringing suit against the association on its note.<sup>12</sup> Many of the cooperative statutes authorize the taking of notes in payment for stock in associations formed under them.<sup>13</sup> Between the original parties to a negotiable note some defenses to a suit on the note may be made that are not available if a suit is brought on the note by a holder in due course. But even between the original parties, a signer of a note is restricted in the defenses which he may successfully make.

When an association was induced to execute a note by promises, which the payee of the note did not fulfill and which were made with no intention of fulfilling them, this was a defense to a suit on the note;<sup>14</sup> but "Mere promises, predictions, or opinions as to future transactions or events do not warrant relief as for deceit, where they are not performed or do not come true" and such statements were held not to constitute a defense to a note.<sup>15</sup>

When dividends on stock for which the purchaser gave his note were insufficient to pay the note over a period of years, although the rights of creditors were not involved, on the liquidation of the company the purchaser was held liable for the unpaid balance on the note, notwithstanding that it was originally understood the note would be paid out of dividends.<sup>16</sup>

A person gave an unconditional promissory note for stock in a cooperative. It was held the fact that it was represented to him at the time of the signing of the note that it would be paid by applying 8 percent of the amount of purchases made by him from the association on the note was immaterial and did not operate to relieve him from liability on the note.<sup>17</sup>

<sup>9</sup> *Rankin v. City National Bank*, 208 U. S. 541, 28 S. Ct. 346, 52 L. Ed. 610; *Skud v. Tillinghast*, 195 F. 1; *In re Tasker's Estate*, 182 Pa. 122, 37 A. 924.

<sup>10</sup> *Clark v. Layman*, 144 Kan. 711, 62 P. 2d 897.

<sup>11</sup> *Runciman v. Brown*, 223 Mich. 298, 193 N. W. 880. See also *Taylor v. Rugenstein*, 245 Mich. 152, 222 N. W. 107; *Gobles Cooperative Association v. Albright*, 248 Mich. 68, 226 N. W. 876.

<sup>12</sup> *Packard v. Abell*, 113 N. Y. S. 1005.

<sup>13</sup> See sec. 14 of Bingham Cooperative Marketing Act of Kentucky, p. 304 of Appendix.

<sup>14</sup> *Lockney Farmers' Cooperative Society v. Egan*, 275 S. W. 732, 284 S. W. 937 (Tex. Civ. App.).

<sup>15</sup> *Industrial Cooperative Union v. Lewis*, 174 Wis. 466, 182 N. W. 861.

<sup>16</sup> *Dealers Finance Company v. Woodard*, 151 So. 145, reversing 147 So. 556.

<sup>17</sup> *Bushnell v. Elkins*, 34 Wyo. 495, 245 P. 304, 51 A. L. R. 13.

Normally, if an association borrowed money on its own note, which was signed on its behalf by its proper officers, the officers would not be personally liable for the amount involved. However, in a Louisiana case a cooperative executed a note and each of its directors placed his name upon the back of the note. They contended that they had thus signed only for the purpose of showing that the president and secretary of the association were authorized to issue the note, but this was disputed and they were held to be individually liable as endorsers.<sup>18</sup>

An officer, in signing an association note, should make it entirely plain upon the face thereof that he is signing in his official and not in his personal capacity. The normal way is for the name of the association to be affixed to the note by a proper officer, with a statement thereunder that it was affixed thereto "by" him, followed by his title.<sup>19</sup> Although members of an association are not liable for its debts under the statute under which an association is formed, this does not prevent members from giving or endorsing notes to or for the association on which they may be held liable. Likewise, it does not prevent members of an association from agreeing among themselves to furnish money to enable the association to pay its debts.<sup>20</sup>

## **Agency**

### **Cooperatives as Agents**

AS A GENERAL rule, whatever an individual may do in person he may do through an agent. And the doctrine is well established that one who acts through an agent acts himself. An agent derives all his authority from his principal—the one for whom he is acting. Cooperatives frequently act as agents for members in the sale of produce or the purchase of supplies, and it is therefore important to consider the rights and liabilities of such associations and of their members under these circumstances. A cooperative that is acting as an agent may sue in its own name on account of a breach of a contract entered into by it with a third person.<sup>21</sup> Likewise where an association was the sole agent of growers for the handling and marketing of their tobacco, it was held the association could have maintained a suit in its own name for the recovery of damages for the negligent destruction of tobacco without joining any of the growers.<sup>22</sup>

A case<sup>23</sup> decided in 1922, by the Supreme Court of Washington, illustrates one of the important problems that may arise. A peach fruit growers' association entered into a contract in its name covering the sale and delivery of fruit of its members. Certain of the members of the fruit growers' association delivered a part of their fruit to the plaintiff, but sold and disposed of a quantity thereof to another dealer.

Plaintiff brought suit against the members in question to recover an amount equal to the profits which it claimed it would have made if the

<sup>18</sup> *Herring v. Farmers' Cooperative Association*, 148 La. 557, 87 So. 271.

<sup>19</sup> *Agricultural Bond & Credit Corporation v. Courtenay Farmers' Cooperative Association*, 64 N. D. 253, 251 N. W. 881.

<sup>20</sup> *Farmers' Coop. Union of Lyons v. Reynolds*, 127 Kan. 16, 272 P. 108; *Thomas County Cooperative Business Association of Colby v. Pearson*, 124 Kan. 430, 260 P. 623.

<sup>21</sup> *Tustin Fruit Association v. Earl Fruit Company*, 6 Cal. Unrep. 37, 53 P. 693.

<sup>22</sup> *Louisville & Nashville Railroad Company v. Burley Tobacco Society*, 147 Ky. 22, 143 S. W. 1040. See also *Dairymen's League Coop. Association, Inc. v. Hartford Accident and Indemnity Company*, 300 N. Y. S. 431, 252 App. Div. 527.

<sup>23</sup> *Barnett Bros. v. Lynn*, 118 Wash. 315, 203 P. 389, 390. See also *Phez Co. v. Salem Fruit Union*, 103 Ore., 514, 201 P. 222, 205 P. 970, 25 A. L. R. 1090.

members had delivered all the fruit in accordance with the contract. The contract, as stated, was with the fruit growers' association and did not state that it was made for the benefit of the members. Defendants claimed that for this reason they could not be sued on the contract. The court held that plaintiff could maintain a suit against the defaulting members because they had delivered some fruit to plaintiff under the contract. The court said:

\* \* \* if a principal not disclosed by a contract made by and in the name of his agent subsequently claims the benefit of the contract, it thereby becomes his own to the same extent as if his name had originally appeared as the contracting party.

In a companion case,<sup>24</sup> decided at the same time and involving the same contract, the facts being that the members sued had not delivered any fruit under the contract, and hence it could not be said (as was said in the other case) that they had claimed the benefit of the contract, it was held that the plaintiff could not maintain a suit against the members involved, and that if any suit was to be maintained it would have to be against the fruit growers' association. It is clear that in either of the cases discussed the buyer of the fruit could have sued the fruit growers' association for the loss sustained through failure to deliver all the fruit contracted for. If the contract with the buyer had stipulated that it was with the association exclusively, the members could not have been successfully sued in either case.

It should be noted that a provision in the contract of an association with its members cannot be invoked to relieve the members of liability to third persons under circumstances similar to those involved in the cases just discussed, unless the provision was brought to the attention of the persons with whom the association contracted prior thereto.<sup>25</sup> In the Federal courts, and it is believed, in most States, the fruit buyer in the last Washington case referred to would have been allowed to sue the members who had not delivered a part of their fruit. The Supreme Court of the United States has said: "The contract of the agent is the contract of the principal, and he may sue or be sued thereon, though not named therein."<sup>26</sup>

In other words, the general rule appears to be that where a contract is entered into with an agent, the agent contracting in his own name, the person for whom the agent is acting, the principal, may sue the other party on the contract, and in turn the principal may be sued by such party. The fact that the existence of the principal is known or unknown to the opposite party at the time the contract is made is immaterial.<sup>27</sup> Of course, a cooperative could include a provision in its contract with one with whom it was dealing that would control the situation.

In connection with the general matter now under discussion it should be remembered that members of an association are liable to suit, or they may sue, not because they are members of the association, but because they are the principals for whom the association acted. As has already been noted, an incorporated cooperative is an artificial entity, separate and apart from its members. No case has been found in which members of an association have been held liable for wrongful acts or negligence of an association that acted as agent for members in the transaction of certain business or in the doing of certain work authorized by them, but no reason is apparent why they could not be so held in a proper case.

The true conception of this matter can be readily understood when one

<sup>24</sup> *Barnett Bros. v. Lynn*, 118 Wash. 308, 203 P. 387.

<sup>25</sup> *Kruse v. Seiffert & Weise Lumber Co.*, 108 Iowa 352, 79 N. W. 118.

<sup>26</sup> *Ford v. Williams*, 62 U. S. 287, 289, 16 L. Ed. 36.

<sup>27</sup> *Chapman v. Java Pac. Line*, 241 F. 850, and numerous cases therein cited.



bears in mind that a person is liable, as a general rule, for all acts of his agent while the agent is acting within the scope of his employment.<sup>28</sup> The character of the agent, whether an individual, partnership, or incorporated association,<sup>29</sup> is immaterial. It is upon this theory that automobile owners, whether individuals or corporations, are held liable for injuries to others caused by the negligent driving of their machines by their agents or employees. It is no answer that an agent was not authorized to do the particular act which caused injury or loss if it was done while in the course of the business of his principal or employer.

In a California case,<sup>30</sup> involving application of an apportionment of income statute for corporation franchise tax purposes, it was held that a farming corporation which marketed some of its produce through cooperatives of which it was a member was not doing business outside the State simply because the associations, although acting as marketing agents, made sales outside the State. This would appear to be a somewhat restrictive interpretation for purposes of the tax statute. However, as pointed out in the opinion, the handling of commodities for a foreign corporation by factors or commission merchants does not ordinarily cause the foreign corporation to be doing business in the State in which such factors or commission merchants are located; and they function as agents.

### Cooperatives Liable for Acts of Agents

Incorporated cooperatives, like other corporations, are liable for the acts of their agents while such agents are acting within the scope of their employment.<sup>31</sup> A corporation may be liable for assault and battery, conversion, nuisance, trespass, libel<sup>32</sup> and slander,<sup>33</sup> malicious prosecution, wrongful arrest, false imprisonment, fraud and deceit.<sup>34</sup> It may also be guilty of crimes.<sup>35</sup> It is apparent that all the acts enumerated would have to be done by the officers, agents, or employees of a corporation, as a corporation can act in no other way.

There is nothing in the nature of an incorporated cooperative to relieve it from liability under circumstances in which any other type of corporation would be liable, and undoubtedly such associations may be held liable in the proper case for any of the matters mentioned above. For instance, in a California case, it appeared that the Escondido Citrus Union furni-

<sup>28</sup> *Hudson Cooperative Loan Association v. Horowitz*, 116 N. J. L. 605, 186 A. 437.

<sup>29</sup> *Alabama Power Co. v. Bodine*, 213 Ala. 627, 105 So. 869; *New York Trust Co. v. Carpenter*, 250 F. 668.

<sup>30</sup> *Irvine Co. v. McColgan*, 26 Cal. 2d 160, 157 P. 2d 847.

<sup>31</sup> *Farmers Union Warehouse Co. v. Barnett Bros.*, 223 Ala. 435, 137 So. 176; *Ely, Salyards & Co. v. Farmers' Elevator Company of Nohle*, 69 Mont. 265, 221 P. 522; *Federal Chemical Company v. Farmers Produce Exchange*, 123 S. W. 2d 612 (Mo. App.); *Cooperative Stores Company v. Marianna Hotel Company*, 128 Ark. 196, 193 S. W. 529; *Kasch v. Farmers' Gin Company*, 3 S. W. 2d 72 (Tex. Com. App.); *Pacific Wool Growers v. Draper & Co.*, 158 Ore. 1, 73 P. 2d 1391; *Seaman v. Big Horn Canal Association*, 29 Wyo. 391, 213 P. 938; *Leonard v. North Dakota Cooperative Wool Marketing Association*, 72 N. D. 310, 6 N. W. 2d 576.

<sup>32</sup> *Aetna Life Insurance Company v. Mutual Benefit Health & Accident Association*, 82 F. 2d 115. See *Pure Milk Producers' Association of Greater Kansas City Territory v. Bridges*, 146 Kan. 15, 68 P. 2d 658.

<sup>33</sup> *Buckeye Cotton Oil Co. v. Sloan*, 250 F. 712.

<sup>34</sup> *Hill v. Associated Almond Growers of Paso Robles*, 90 Cal. App. 291, 265 P. 873; *Vest v. Farmers Cooperative Elevator Co. of Riverdale*, 108 Neb. 407, 187 N. W. 892; *Placentia Coop. Orange Growers' Association v. Henning*, 118 Cal. App. 487, 5 P. 2d 444; 10 Fletcher CYCLOPEDIA CORPORATIONS, Perm. Ed., sec. 4876 et seq.

<sup>35</sup> 10 Fletcher CYCLOPEDIA CORPORATIONS, Perm. Ed., sec. 4944.

gated the orchard of one of its members without his consent, and in a negligent manner. As a result, the orchard was badly damaged. The member then brought suit against the union and recovered a judgment for \$2,250.<sup>36</sup> In another California case officers of a corporation unlawfully entered vineyards and removed grapes therefrom. It was held that the corporation was liable for their acts.<sup>37</sup>

It is true that an electric cooperative was held not liable for the tort of one of its agents while apparently acting within the scope of his employment;<sup>38</sup> but this case is believed to be contrary to the weight of authority.<sup>39</sup>

If an agent is not acting within the scope of his authority an association is not liable for his acts.<sup>40</sup>

## Taxes

### General Taxes

IN every State it is believed the physical property of a cooperative, such as buildings and office or other equipment, is liable for property taxes on the same basis as similar property owned by others. Taxes must be imposed pursuant to law, and those imposed by a State or any municipality or subdivision thereof must be imposed in accordance with laws that are in harmony with the State and Federal constitutions. Broadly speaking, a State or the Federal Government has relatively comprehensive powers with respect to the classifying of property for taxation.

Is an association liable for property taxes on products received from its members for marketing, if it is in possession of such products at the time property taxes are assessed? This is a local question but, generally, if an association takes title to the products which it is engaged in marketing, there appears to be little doubt that it would be liable for taxes thereon. If an association simply acts on an agency basis in the marketing of products, ordinarily it would not be liable for such taxes because, as a rule, taxes are imposed upon the owner of property or the person who occupies the relation of principal rather than upon the agent who may have custody of the property or be employed to sell the same. In a Kentucky case it was said, referring to the Burley Tobacco Growers' Cooperative Association: "Under its charter and the marketing agreement shown above, the association is authorized to incur all necessary expenses in holding and marketing, and this, together with the absolute legal title and full control of the article, certainly includes liability for taxation."<sup>41</sup>

In Massachusetts it was held that a city of that State was entitled to tax tobacco in the hands of an association that was stored by it within the city, the tobacco having been received by the association under a purchase-and-

<sup>36</sup> *Andreen v. Escondido Citrus Union*, 93 Cal. App. 182, 269 P. 556.

<sup>37</sup> *California Grape Control Board, Ltd. v. Boothe Fruit Company*, 220 Cal. 279, 29 P. 2d 857.

<sup>38</sup> *Arkansas Valley Cooperative Rural Electric Co. v. Elkins*, 200 Ark. 883, 141 S. W. 2d 538.

<sup>39</sup> *Lichty v. Carbon County Agricultural Association*, 31 F. Supp. 809. See also *Keifer & Keifer v. Reconstruction Finance Corporation and Regional Agricultural Credit Corporation*, 306 U. S. 381, 59 S. Ct. 516, 83 L. Ed. 784.

<sup>40</sup> *Farmers' Coop. Shipping Association v. George A. Adams Grain Co.*, 84 Neb. 752, 122 N. W. 55; *David Stott Flour Mills, Inc. v. Saginaw County Farm Bureau*, 237 Mich. 657, 213 N. W. 147; *Christian v. Rice Growers Association of California*, 50 Cal. App. 2d 617, 123 P. 2d 534.

<sup>41</sup> *Burley Tobacco Growers' Coop. Association v. City of Carrollton*, 208 Ky. 270, 270 S. W. 749, 751.

sale contract. The court said: "The tobacco on which the tax was levied was the property of the plaintiff." The association involved was organized in Connecticut but was doing business in Massachusetts.<sup>42</sup>

In the Kentucky case referred to, involving the question of the liability of an association for city taxes on tobacco that it had on hand in the city on assessment day, which tobacco had been received by it under a purchase-and-sale contract, section 31 of the cooperative act of that State was declared unconstitutional<sup>43</sup> because the practical effect of that section was to exempt "all products held by the association from all taxation," thus violating the rule of uniformity required by the State constitution and adding to the exemptions allowed thereunder.<sup>44</sup> No other cooperative statute contains a taxation provision like that in the Bingham Act.

In a later Kentucky case, which involved the right of a city in Kentucky to impose taxes on tobacco stored therein by the Dark Tobacco Growers' Association, received by it under a purchase-and-sale contract, it was held that the city was not entitled to levy taxes on the tobacco because the constitution of the State authorized its general assembly "to determine what class or classes of property shall be subject to local taxation," and an act of the assembly declared that "agricultural products in the hands of the producer or in the hands of any agent or agency of the producer to which said products had been conveyed or assigned for the purpose of sale by the producer" were exempt from liability for local taxes. Although the marketing contract under which the tobacco was received was a purchase-and-sale contract, the court was of the opinion that, inasmuch as the "central purpose in the contract was to create an agency with the absolute power in the designated agent to handle and market the tobacco of the grower," the exemption statute covered a situation of this kind.<sup>45</sup>

In an Arizona case<sup>46</sup> it was held that a wholesaler who furnished goods to a cooperative on consignment, not the cooperative, was required to pay the retail sales tax on goods sold under this arrangement.

In a Washington case<sup>47</sup> the court held that an association, about 20 percent of whose stock was held by nonproducers and which paid dividends of approximately 6 percent, was entitled to exemption from an occupation tax. This conclusion was based on the fact that, as the statute exempted individual farmers, this exemption continued even though the farmers acted through an incorporated cooperative. In this connection, the court said:

The fact that they operate through a corporate entity in which they own the stock and the corporation makes no profit and distributes the proceeds after a sale and the payment of the expenses on a pro rata per box basis does not put them in a materially different situation than if two or more of them cooperated simply as members of a joint undertaking without corporate existence.

After the occupation tax statute of Washington, referred to above, had been amended so as to include specifically "nonprofit" associations and the word "business" had been defined as including "all activities engaged in

<sup>42</sup> *Connecticut Valley Tobacco Association, Inc. v. Inhabitants of Town of Agawam*, 261 Mass. 110, 158 N. E. 506.

<sup>43</sup> See sec. 31 of Bingham Cooperative Marketing Act of Kentucky, p. 307 of Appendix.

<sup>44</sup> *Burley Tobacco Growers' Coop. Association v. City of Carrollton*, 208 Ky. 270, 270 S. W. 749.

<sup>45</sup> *City of Owensboro v. Dark Tobacco Growers' Association*, 222 Ky. 164, 300 S. W. 350, 351, 352.

<sup>46</sup> *State Tax Commission of Arizona v. Martin*, 57 Ariz. 283, 113 P. 2d 640.

<sup>47</sup> *Yakima Fruit Growers' Association v. Henneford*, 182 Wash. 437, 47 P. 2d 831, 833, 100 A. L. R. 435. See also *Brady Irrigation Co. v. Teton County*, 107 Mont. 330, 85 P. 2d 350.



with the object of gain, benefit or advantage to the taxpayer or to another person or class, directly or indirectly," the court held <sup>48</sup> certain cooperatives subject to the tax "as to their activities of warehousing, cold storage, and the sale of fruit."

A corporation, chartered as an ordinary business corporation but doing most of its business on a cooperative basis, was held by the Supreme Court of Pennsylvania not to be subject in connection with such business to a gross receipts tax levied on "every person engaged in business," where "business" was defined as an activity carried on for "gain or profit." <sup>49</sup>

In Georgia it has been held <sup>50</sup> that an "association occupied the status of its individual members as to \* \* \* production and sales," and that "An attempted levy by a municipal corporation of an ad valorem tax on accounts receivable for money, due to a cooperative marketing agency \* \* \* from the sales of the dairy products \* \* \* is in effect a tax on the gross sales of such products," which tax was prohibited.

Under the Employment Compensation Act of the State of Colorado "agricultural labor" was specifically excepted. A cooperative, incorporated in that State under a statute which provided that any exemptions applicable to agricultural products in the possession or under the control of the individual producer should be applicable to such products after their delivery to an association by its members, was held not to be required "to pay contributions on the wages of individuals employed by it." The court said:

\* \* \* because of the peculiar relationship between the cooperative association and its members, it would seem evident that such of the purely agricultural activities of the producer members as are incidental to his ordinary farming operations remain so whether they are performed by him on his farm or for him through the medium of his cooperative marketing association. By the circumstance that the expense of marketing service as if he had paid his individual employees for doing the same work. the farmer member just as directly pays the wages for all labor involved in the marketing service as if he had paid his individual employees for doing the same work. In either case the labor incident thereto is "agricultural labor" and that is what the statute exempts.

The court stated that a different result might be reached if the farm products were being marketed by a commercial "profit corporation," or if they were "not marketed in an unmanufactured state." <sup>51</sup>

A cooperative irrigation company in Montana was held not liable for property taxes on its lands owned in fee, its reservoir, site, dams, ditches, canals, and like property. <sup>52</sup> The court drew a sharp distinction, from a tax standpoint, between a commercial and a cooperative irrigation company. It held that in the case of a cooperative irrigation company, where the right to water was appurtenant to the land of the cooperators, the value of all the property of the cooperative was reflected in the value of the lands of the individual owners and was taxed there.

In a Kansas case the court held that a cooperative engaged in the han-

<sup>48</sup> *Yakima Fruit Growers' Association v. Henefford*, 187 Wash. 429, 60 P. 2d 62, 65.

<sup>49</sup> *School Dist of Philadelphia v. Frankford Grocery Co.*, 376 Pa. 542, 103 A. 2d 738.

<sup>50</sup> *Georgia Milk Producers Confederation v. City of Atlanta*, 185 Ga. 192, 194 S. E. 181.

<sup>51</sup> *Industrial Commission v. United Fruit Growers Association*, 106 Colo. 223, 103 P. 2d 15, 18. See as bearing upon this matter: *Great Western Mushroom Company v. Industrial Commission*, 103 Colo. 39, 82 P. 2d 751; *Park Floral Company v. Industrial Commission*, 104 Colo. 350, 91 P. 2d 492; *Duys & Company v. Tone*, 125 Conn. 300, 5 A. 2d 23; *Big Wood Canal Co. v. Unemployment Compensation Division of Industrial Acc. Board*, 61 Idaho 247, 100 P. 2d 49, *Redlands Foothill Groves v. Jacobs*, 30 F. Supp. 995; *Cowiche Growers v. Bates*, 2d 585, 117 P. 2d 624.

<sup>52</sup> *Brady Irrigation Co. v. Teton County*, 107 Mont. 330, 85 P. 2d 350.

dling of wheat was not liable for taxes on account of wheat held by it, under a tax statute relative to merchants, which in effect defined the term "merchant" as one who had "possession of personal property either purchased by it for sale at an advanced price or profit, or consigned to it to be sold in that manner—that is, at an advanced price or profit," because the association did not come within the statutory definition of a merchant. Moreover, the court regarded the association as "a mere instrument through which the members undertake by concerted action to market their own crops," and placed emphasis upon the fact that the members do not bargain with the association over prices<sup>53</sup> but receive all "it receives, less present and future expenses."

On the other hand, a milk cooperative engaged in selling milk produced by its members to milk distributors in the District of Columbia was required to pay a property tax on accounts receivable arising from such sales and a business privilege tax on the basis of gross receipts rather than "gross commissions."<sup>54</sup> The association contended that it was acting as agent for its members and that the accounts receivable in fact belonged to the members. The court rejected this contention and held that the cooperative "was not a mere conduit for the funds of the principal."

A marketing association in Ohio was held subject to the franchise taxes applicable to general corporations.<sup>55</sup> At the time the association was incorporated, the Agricultural Cooperative Marketing Act provided for an annual fee of \$10 in lieu of all franchise or similar corporate taxes. However, this provision was subsequently repealed. After repeal, the Board of Tax Appeals said cooperatives became amenable to the franchise tax provisions of the general corporation laws, since the cooperative act made the general corporation laws applicable, except where there was a conflict.

Also, a farm supply association which operated on a strictly cost basis and followed the plan of "car door deliveries" was held to be a retail dealer, at least with respect to nonmember business, within the meaning of a statute which provided that:

From and after the passage of this act, each retail vendor of or retail dealer in goods, wares and merchandise shall pay an annual mercantile license tax of two dollars, and all persons so engaged shall pay one mill additional on each dollar of the whole volume, gross, of business transacted annually.

The court said:<sup>56</sup>

The practice of buying to sell again is what constitutes one a dealer, and not the intent to make a profit. Whether the appellant is subject to the tax does not depend upon whether it seeks, or has the legal right, to make a profit from its transactions, but whether it buys to sell again. \* \* \* The mercantile license tax is imposed, not upon the property or income, but upon the privilege of selling goods, wares, and merchandise, and is measured by the whole volume, gross, of business transacted annually.

If it were possible for an association to supply goods to its members at exactly the cost thereof and then at the end of the year, after all costs and expenses of doing business had been ascertained, to assess the members

<sup>53</sup> *Kansas Wheat Growers' Association v. Board of Commissioners of Sedgwick County*, 119 Kan. 877, 241 P. 466, 467.

<sup>54</sup> *Maryland & Virginia Milk Producers' Association, Inc. v. District of Columbia*, 119 F. 2d 787, cert. den. 314 U. S. 646, 62 S. Ct. 87, 86 L. Ed. 518.

<sup>55</sup> *Central Ohio Cooperative Milk Producers v. Glander*, 92 N. E. 2d 834 (Ohio Bd. of Tax Appeals).

<sup>56</sup> *Appeal of Beaver County Coop. Association*, 118 Pa. Super. 305, 180 A. 98, 99, 100.

or to require them to pay on a patronage basis the amount required for meeting such costs and expenses, there would be no basis for claiming that such an association had made any profits in the ordinary meaning of that term. What associations engaged in the handling of supplies generally do is to sell such supplies at the prevailing market prices and then pay patronage dividends, in either cash or stock, or otherwise. Thus a condition is brought about that is parallel with the one outlined above. Of course, the question presented to a court in determining whether a cooperative is liable for taxes under a tax statute is to be answered largely by the terms and conditions of that statute. If such terms as "dealer," "income," "profits," and "business" are so defined in a tax statute as to make them applicable to a cooperative and the statute contains no exemptions which apply to such associations, they are taxable.

In other words, whether or not an organization is subject to a particular tax depends upon the statute providing therefor. If an organization is not exempt by the constitution of the State, or by the statute involved, it is subject thereto.

A provision in a statute of Arkansas under which a rural electric cooperative was incorporated provided that "Corporations formed hereunder shall pay annually, on or before July first, to the Secretary of State, a fee of \$10 for each 100 members or fraction thereof, but shall be exempt from all other excise taxes of whatsoever kind or nature, except as provided in this Act."

Because of this exemption provision and for other reasons, a rural electric cooperative contended that it was not liable for a 2 percent sales tax on its sales of electricity to its members. The court held that while the exemption provision exempted the association from paying excise taxes on all property and purchases made by the association, it did not exempt its individual members from paying the sales tax on sales made to them regardless of whether such sales were made at a profit or not. The association unsuccessfully contended that the distribution of electricity to its individual members did not constitute a sale.<sup>57</sup>

In a Washington case<sup>58</sup> an organization formed without capital stock and operating on a cooperative basis for the distribution of electric power among its members, was held subject to a gross income tax; and the term "business" as defined in the statute was held to include the operations of the mutual company. Apparently, the court was of the opinion that the activities of the company were "engaged in with the object of gain, benefit, or advantage, either direct or indirect."

In Indiana a cooperative instituted proceedings under the Uniform Declaratory Judgment Act of that State presenting the question whether the association was exempt from the Gross Income Tax Statute of that State. The statute provided that the tax should be imposed upon the "entire gross income" of those subject thereto. There were excepted from the provisions of the act "members of 'agricultural and horticultural societies \* \* \* not operated for profit, \* \* \* Provided, however, That this exception shall apply only to companies, organizations, corporations and/or societies named in this subsection which are not organized for profit, and no part of the income of which inures to the benefit of any stockholder or other private individual.'" In holding that the cooperative was not exempt the court said:

<sup>57</sup> *McCarroll v. Ozarks Rural Electric Coop. Corp.*, 201 Ark. 329, 146 S. W. 2d 693.

<sup>58</sup> *Peninsula Light Company v. Tax Commission of Washington*, 185 Wash. 669, 56 P. 2d 720.



The gain made here was made in the conduct of a purely commercial business which consisted of making purchases and sales. The difference in the cost of the appellee and its sale price to the purchaser was a profit, gain, or income and this inured to the benefit of the patrons of appellee in the form of \$5 common stock certificates when the amount of business done by appellee and patron warranted such margin of profit. The undisputed evidence was that this stock certificate had some value, consequently it was a gain or profit or income inuring to the benefit of the stockholder and other private individuals as well. The appellee contends that this was a saving to the stockholders of the appellee and should not be classed as income. But this enhanced their total wealth, and whether it be called savings, gain, income, or by any other name, it still renders the appellee liable to the tax intended by the Legislature.<sup>60</sup>

The court further said:

the fact alone that a part of the income insures to the benefit of private individuals not members of the association is sufficient in and of itself to prevent the exemption from extending to the appellee.

Under a New Mexico privilege tax statute, which provided that:

The term "business" when used in this Act shall include all activities or acts engaged in (personal, professional, and corporate) or caused to be engaged in with the object of gain, benefit, or advantage either direct or indirect.

and which statute further provided that there were exempted from taxes imposed thereunder:

The business of societies and other organizations not operated for gain or profit. it was held that a cooperative<sup>60</sup> which, without being required to do so, did business only with members, was operated for gain or profit, and was not exempt. The court said:

The mere fact that plaintiff makes the volume of purchases from it by members, rather than the number of shares owned, the measure of their gain in no way alters the fact that it, as well as its members, receives benefit and advantage in thus fulfilling the very purpose of its corporate existence.

The by-laws contemplate the creation of a reserve fund subject to use in the purchase of new equipment; also, when authorized by the board of directors, in business expansion. Certainly, "business expansion" thus accomplished represents gain or profit to the corporation itself, direct, immediate, and pecuniary and, likewise, to its stockholders upon dissolution.

The meaning of the term "net profits," as used in a tax statute, may have, because of language appearing in the statute a more or less arbitrary meaning, and its exact meaning, unless defined in the statute, should be determined by a consideration of the statute as a whole.<sup>61</sup>

When a statute under which a cooperative was incorporated provided that patronage dividends might be paid after providing for dividends on the capital stock, for reserves, and for an educational fund, it was held that patronage dividends so paid were an expense within the meaning of a tax statute which authorized the deduction of "All the ordinary and necessary expenses paid within the year in the maintenance and operation \* \* \* including \* \* \* salaries \* \* \* rentals \* \* \*," and hence were deductible in determining net profit.<sup>62</sup> On the other hand, it was held that divi-

<sup>60</sup> *Storen v. Jasper County Farm Bureau Cooperative Association*, 103 Ind. App. 77, 2 N. E. 2d 432, 433, 434; *Diekmann v. Evansville Producers Commission Association*, 219 Ind. 636, 40 N. E. 2d 327. Cf. *Department of Treasury v. Ice Service, Inc.*, 220 Ind. 64, 41 N. E. 2d 201 (holding that a cooperative organized by four ice companies as a sales agency for the ice they manufactured and sold through the cooperative was not liable for gross income taxes, since it acted solely as an agency).

<sup>61</sup> *Farmers Oil Co., Inc., v. State Tax Commission*, 41 N. M. 693, 73 P. 2d 816, 817, 818. See also *Maryland & Virginia Milk Producers' Association v. District of Columbia*, 119 F. 2d 787, cert. den. 314 U. S. 646, 62 S. Ct. 87, 86 L. Ed. 518.

<sup>62</sup> *Gallatin Farmers Co. v. Shannon*, 109 Mont. 155, 93 P. 2d 953.

<sup>63</sup> *Gallatin Farmers Co. v. Shannon*, 109 Mont. 155, 93 P. 2d 953, 954.

dends paid on capital stock were not deductible as an expense and the court said that it was "not the same as interest paid on indebtedness."

In Mississippi a cooperative paid patronage dividends to its stockholders in pursuance of a provision in its charter and to nonstockholders in pursuance of agreements entered into with them and it was held that payments so made were not a part of the gross income of the cooperative because "When one receives money in a business transaction which he has no right to retain but must return, his income from the business is neither increased nor diminished thereby; it remains as it would have been had he not received the money at all."<sup>63</sup>

All shares of stock of a credit corporation engaged in the making of loans only to "dairymen who were and are members of cooperative creameries" were held taxable in the county in Idaho in which the corporation had its principal place of business, regardless of whether the residence of the owners of such stock was within or without that State.<sup>64</sup>

An association of fishermen was held liable for the payment of occupation taxes imposed by the State of Washington.<sup>65</sup>

A question is sometimes raised regarding the validity of a tax statute, because it contains provisions for exemption of cooperatives. The Commission Merchants' Regulation Act of the State of Washington required every commission merchant subject thereto to obtain a license and to give a bond, but the act provided that the term "commission merchant" "shall not include nonprofit cooperative marketing organizations." The statute was unsuccessfully attacked as unconstitutional because of this exemption. In this connection, the court referred to associations organized under the Cooperative Marketing Act of the State and said:

Under this act, instead of each producer marketing individually his own products, several producers join together to market the combined product. It is nothing more nor less than a man doing his own marketing. There is no idea of profit to such cooperative association—as brokers.<sup>66</sup>

In a Virginia case a citizen of that State sought, by mandamus proceedings which attacked the constitutionality of the tax exemption provisions of the Cooperative Marketing Act of that State, to compel the taxing authorities of the State to collect taxes from cooperatives organized under that Act, but as the petition did not show any specific duty which the taxing officers had failed to perform, or show what taxes, if any, were due, the proceedings failed.<sup>67</sup>

Because a city was acting to protect the public health, it was held that a dairy cooperative was not entitled to a writ of prohibition to enjoin officials of the city from prosecuting it for distributing milk without obtaining a license to do so.<sup>68</sup>

A city ordinance authorizing the mayor to grant licenses "to such persons as in his judgment shall appear proper and best calculated to secure to the inhabitants of the city pure and wholesome milk," and which made unauthorized sales a misdemeanor, was held to be applicable to an association.<sup>69</sup>

<sup>63</sup> *State v. Morgan Gin Company*, 186 Miss. 66, 189 So. 817, 818.

<sup>64</sup> *Intermountain Agricultural Credit Association v. Payette County*, 54 Idaho 307, 31 P. 2d 267.

<sup>65</sup> *Fishermen's Coop. Association v. State*, 198 Wash. 413, 88 P. 2d 593.

<sup>66</sup> *Northern Cedar Company v. French*, 131 Wash. 394, 230 P. 837, 841. See also *Lloyd Garretson Company v. Robinson*, 178 Wash. 601, 35 P. 2d 504.

<sup>67</sup> *Lehman v. Morrisett*, 162 Va. 463, 174 S. E. 867.

<sup>68</sup> *Pure Milk Producers & Distributors Associations v. Morton*, 276 Ky. 736, 125 S. W. 2d 216.

<sup>69</sup> *People ex rel. Larrabee v. Mulholland*, 82 N. Y. 324, 37 Am. Rep. 568.

Many of the cooperative statutes contain a provision reading substantially as follows: "Each association organized hereunder shall pay to the State tax commission an annual fee of \$10, in lieu of all franchise, or license, or corporation taxes."<sup>70</sup> The scope and effect of a provision similar to that quoted was involved in a Virginia case.<sup>71</sup> It appeared that the association was conducting a general merchandise business and was handling, among other things, dry goods, groceries, drugs, and patent medicines. The statute under which the association was incorporated authorized the incorporation thereunder of associations for "supplying to its members of machinery, equipment, or supplies." The declaration of policy contained in the statute, after stating advantages expected to be derived from the handling and marketing of agricultural products cooperatively, recited that the statute was enacted "to obtain these said benefits in the distribution of supplies purchased by agricultural producers." The term "supplies," was defined in the statute as including "seed, feed, fertilizer, equipment, and other products used in the production of crops and livestock and in the operation of farms and farm houses \* \* \*"

In view of the statutory provisions referred to, the court held that the association was not authorized to handle general merchandise, but that it was authorized to handle only those "things which have a peculiar connection with agricultural production," and the appellate court approvingly quoted the following from the opinion of the trial court:

It is the authorized business of the association to which the exemption attaches and not to the association as such, independent of the character of business carried on by it. Therefore, if and when an association goes beyond its powers and deals in a class of merchandise not authorized by the Act, it cannot escape assessability and should properly be taxed as a general merchant, to the extent, at least, of its unauthorized sales.

The Federal revenue acts of 1921 and 1924 contained a stamp-tax provision<sup>72</sup> reading: "Capital stock, issued: On each original issue, whether on organization or reorganization, of certificates of stock, or of profits, or of interest in property or accumulations, by any corporation, on each \$100 of face value or fraction thereof, 5 cents."

The Kansas Cooperative Wheat Marketing Association, a nonstock organization, paid, under protest, a stamp tax of 5 cents on each of its certificates of membership under the foregoing provision. The association then successfully brought suit for the recovery of the amount paid.<sup>73</sup> The court held that the certificates of membership of the association did not come within the scope of the statutory provision in question and said that "Before any member has anything of monetary value in the hands of the association, he must not alone have become a member, as shown by certificate of membership, but must further have delivered wheat to the association; that two or a dozen certificates of membership in the association are of no more actual worth or value than is one."

It has been held that voting trust certificates issued in pursuance of a voting trust agreement are subject to this stamp tax.<sup>74</sup>

<sup>70</sup> New York Laws 1926, ch. 231, sec. 130. But see *California Pear Growers' Association v. Johnson*, 219 Cal. 98, 25 P. 2d 414.

<sup>71</sup> *Rockingham Cooperative Farm Bureau, Inc. v. City of Harrisonburg*, 171 Va. 339, 198 S. E. 908. See also *Forrester v. Georgia Milk Producers Confederation*, 66 Ga. App. 696, 19 S. E. 2d 183; *O'Neil v. United Producers & Consumers Coop.*, 113 P. 2d 645 (Ariz.).

<sup>72</sup> 42 Stat. 227, 303; 43 Stat. 253, 334.

<sup>73</sup> *Kansas Coop. Wheat Marketing Association v. Motter*, and *Kansas Wheat Growers' Association v. Motter*, 14 F. 2d 242, 243.

<sup>74</sup> *Pennroad Corporation v. Ladner*, 21 F. Supp. 575.



The stamp provision quoted above was amended by section 441 of the revenue act of 1928<sup>75</sup> so as to make it plain that the provision referred to did not apply to "stocks and bonds and other certificates of indebtedness issued by any farmers' or fruit growers' or like associations organized and operated on a cooperative basis for the purposes, and subject to the conditions, prescribed in paragraph (12) of section 231" of the revenue act of 1926. This provision has been carried forward substantially unchanged in the Revenue Code of 1954.<sup>76</sup>

It is highly important that every cooperative or subsidiary thereof should carefully ascertain its tax status. In some States the failure of a corporation to pay license or franchise taxes may adversely affect the corporation. For example, in California the powers of a corporation which has failed to pay franchise taxes may be suspended and a corporation whose powers have been so suspended loses the right to defend a suit which has been brought against it.<sup>77</sup>

Under the Constitution of Wisconsin it has been held that money raised by taxation may not be appropriated and used in advising with

\* \* \* individuals or groups of the requirements advisable for consideration in the organization of a cooperative association and so to promote the organization, collect and disseminate such information, and engage in such educational activities as he might deem advisable to make available information relative to the benefits to be derived from the organization of a cooperative association \* \* \*<sup>78</sup>

in a particular county, as this was regarded as a local and not as a State problem.

### Federal Income Taxes

Six times, following the adoption of the 16th (income tax) amendment, the Congress of the United States in tax legislation has enacted provisions dealing specifically with farmer cooperatives. In each instance the distinct character of the cooperative form of doing business has been recognized. The Congress also has clearly manifested a desire to foster these mutual, self-help institutions for farmers.

The Revenue Act of 1913, first after the amendment, did not specifically mention cooperatives. It did, though, exempt certain types of nonprofit concerns, including "agricultural and horticultural organizations."<sup>79</sup>

The Treasury Department at first construed this language to include cooperative dairies without capital stock. This ruling was soon replaced by one holding that although cooperative dairies could offset gross income by the amount of patronage refunds "actually paid," any amount retained at the end of the year over and above expenditures was returnable as net income.

An extremely narrow exemption for agency marketing cooperatives which dealt only with members was included in the 1916 act.<sup>80</sup> Five years later, in the 1921 act, these provisions were broadened to include farmer cooperatives acting as purchasing agents for members.<sup>81</sup>

<sup>75</sup> 45 Stat. 791, 867; 26 U. S. C. A. 1808.

<sup>76</sup> 26 U. S. C. A. 4382 (a) (3).

<sup>77</sup> *Boyle v. Lakeview Creamery Company*, 9 Cal. 2d 16, 68 P. 2d 968.

<sup>78</sup> *State ex rel. Wisconsin Development Authority v. Dammann*, 228 Wis. 147, 280 N. W. 698, 716, setting aside opinion appearing in 277 N. W. 278.

<sup>79</sup> 38 Stat. 166, 172.

<sup>80</sup> 39 Stat. 756, 767. Sec. 11, Eleventh, exempted "Farmers', fruit growers', or like associations, organized and operated as a sales agent for the purpose of marketing the products of its members" and turning back to them, on a patronage basis, the proceeds less selling expenses.

<sup>81</sup> 42 Stat. 227, 253.

The bare language of this statute required substantial interpretative regulations to accommodate the increasingly complex structures of farmer cooperatives as they were being organized and operated in the early 1920's. Thus, in regulations published in 1921, the issuance to farmer-producers of capital stock having limited dividend rights was authorized. In 1922, regulations under the 1921 act authorized the accumulation of reasonable reserves. The term "producer" rather than "member" appeared in regulations under the 1924 act, clearing the way for limited dealings with nonmembers.

These departmental practices all found their way into the Revenue Act of 1926.<sup>82</sup> Except for the addition in 1934<sup>83</sup> of provisions permitting business done with the United States to be disregarded in determining the right to exemption, no change in the 1926 law was made until the Congress enacted section 314 of the Revenue Act of 1951.<sup>84</sup>

Section 314 repealed none of the existing law, but it added a special tax treatment for all associations qualifying for "exemption" under the existing law. In other words, compliance with the "exemption" statute for taxable years beginning after December 31, 1951, no longer gives complete exemption. It merely authorizes a complying association to make certain additional deductions and other adjustments in the computation of its statutory net income under the Internal Revenue Code. Like nonexempt cooperatives, such complying associations also may *exclude* from gross income patronage refunds which they are under a prior mandatory obligation to make to their patrons.<sup>85</sup>

The complete revision of the Internal Revenue Code in 1954 made no substantive changes in the law as it stood after the 1951 act became effective. The pertinent sections of the Internal Revenue Code of 1954 relating to farmers' marketing and farm supply associations are as follows:<sup>86</sup>

SEC. 521. Exemption of farmers' cooperatives from tax:

(a) *Exemption from tax.*—A farmers' cooperative organization described in subsection (b) (1) shall be exempt from taxation under this subtitle except as otherwise provided in section 522. Notwithstanding section 522, such an organization shall be considered an organization exempt from income taxes for purposes of any law which refers to organizations exempt from income taxes.

(b) *Applicable rules.*—

(1) *Exempt farmers' cooperatives.*—The farmers' cooperatives exempt from taxation to the extent provided in subsection (a) are farmers', fruit growers', or like associations organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

(2) *Organizations having capital stock.*—Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8

<sup>82</sup> 44 Stat. 9, 40. Sec. 231 (12) of this act, in summary, provided that a cooperative might act as principal as well as agent and thus take title to goods marketed and purchased; that it might accumulate reasonable reserves; that it might issue voting stock to producers with limited dividend rights and that it might carry on as much as 50 percent of its business with nonmembers, so long as purchasing business for nonmember nonproducers is limited to 15 percent.

<sup>83</sup> 48 Stat. 680, 701.

<sup>84</sup> 65 Stat. 452, 491.

<sup>85</sup> See "Taxation of Nonexempt Cooperatives," *infra*.

<sup>86</sup> 68A Stat. 176-8; 26 U. S. C. A. 521-522.

percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association.

(3) *Organizations maintaining reserve.*—Exemption shall not be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

(4) *Transactions with nonmembers.*—Exemption shall not be denied any such association which markets the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, or which purchases supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of all its purchases.

(5) *Business for the United States.*—Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this section.

SEC. 522. Tax on farmers' cooperatives:

(a) *Imposition of tax.*—An organization exempt from taxation under section 521 shall be subject to the taxes imposed by section 11 or section 1201.

(b) *Computation of taxable income.*—

(1) *General rule.*—In computing the taxable income of such an organization there shall be allowed as deduction from gross income (in addition to other deductions allowable under this chapter)—

(A) amounts paid as dividends during the taxable year on its capital stock, and

(B) amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. Allocations made after the close of the taxable year and on or before the 15th day of the 9th month following the close of such year shall be considered as made on the last day of such taxable year to the extent the allocations are attributable to income derived before the close of such year.

(2) *Patronage dividends, etc.*—Patronage dividends, refunds, and rebates to patrons with respect to their patronage in the same or preceding years (whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount of such dividend, refund, or rebate) shall be taken into account in computing taxable income in the same manner as in the case of a cooperative organization not exempt under section 521. Such dividends, refunds, and rebates made after the close of the taxable year and on or before the 15th day of the 9th month following the close of such year shall be considered as made on the last day of such taxable year to the extent the dividends, refunds, or rebates are attributable to patronage occurring before the close of such year.

It is clear that Congress had the right to exempt agricultural cooperatives from the payment of Federal income taxes.<sup>87</sup> The special treatment in the present law is not unusual<sup>88</sup> and likewise is legal.

At the time this text was prepared, the Internal Revenue Service<sup>89</sup> was in the process of issuing new regulations under the quoted sections of the 1954 Code. In the interim, the regulations under the 1939 Code as

<sup>87</sup> *Flint v. Stone Tracy Co.*, 220 U. S. 107, 173, 31 S. Ct. 342, 55 L. Ed. 389; *Brushaber v. Union Pacific Railroad Co.*, 240 U. S. 1, 36 S. Ct. 236; 60 L. Ed. 493, L. R. A. 1917 D 414, Ann. Cas. 1917 B 713; *Stanton v. Baltic Mining Co.*, 240 U. S. 103, 36 S. Ct. 278, 60 L. Ed. 546.

<sup>88</sup> The Internal Revenue Code is replete with differing rules on differing groups, classes or types of taxpayers. SILVERSTEIN, SPECIAL SITUATIONS UNDER THE FEDERAL INCOME TAX LAW, Mimeo. by National Council of Farmer Cooperatives, 1955, 29 pp.

<sup>89</sup> The Internal Revenue Service is the part of the Treasury Department charged with the duty of collecting Federal taxes. Prior to 1953, it was known as the "Bureau of Internal Revenue." All "Internal Revenue" rulings will be cited herein as those of the "Service," although made when the name was "Bureau."



amended in 1951 were continued effective as to taxable years coming after the effective date of the 1954 Code.<sup>90</sup>

There are at least 10 fundamental conditions embodied in section 521, which have been summarized<sup>91</sup> as follows:

#### OPERATING REQUIREMENTS

1. Operating purposes must be restricted.
2. Operations must be of a mutual nature, with equal treatment for all patrons.
3. Business with nonmembers must not exceed that done with members.
4. Financial reserves must have a necessary purpose and must be reasonable in amount.
5. Patronage and equity records must be maintained and must be permanently preserved.
6. Supplies and equipment purchased for nonmembers who are not producers must be limited.

#### OWNERSHIP AND CONTROL REQUIREMENTS

7. Substantially all voting rights must be held by actual producers who currently patronize the association.
8. Substantially all capital shares, of participating type, must be owned by actual producers.
9. The rate of dividends (or interest) on capital shares must be limited.

#### GENERAL REQUIREMENT

10. Legal structure of association must be cooperative in principle and must not contain provisions inconsistent with the foregoing requirements.

Since the changes in the law made in 1951 and 1954 did not alter these requirements in any respect, the basic rulings on these matters are still applicable. These will now be discussed.

The term "like association" as used in the statute has been construed by the Internal Revenue Service to include a farmer cooperative organized to establish and operate a roadside or farmers' market for its members.<sup>92</sup>

The expression "like associations" by reason of its association with the words "farmers" and "fruit growers" is limited by them and refers only to associations of farmers or others engaged in like occupations.<sup>93</sup>

If an association is not actually organized so as to meet the requirements for exemption, it is ineligible therefor. In a case decided by the Board of Tax Appeals, it was said:<sup>94</sup>

The undisputed proof in this case shows that at least 30 percent of the profit realized by the petitioner from the operation of its elevator department was from nonstockholders to whom it did not and could not turn back anything other than the original price paid them for their grain, which was the market price. \* \* \*

\* \* \* \* \*

The petitioner's case is not strengthened by the fact that up to the end of the year 1928 it had not paid any patronage dividends with the exception of certain patronage dividends in the form of shares of stock upon the business of 1918. The simple fact is that the petitioner was not in 1928 organized to come within the exempting provisions of the statute.

<sup>90</sup> The new regulations under the 1954 Code will appear in 26 C. F. R. 1.521-1.522.3, inc. The regulations under the 1939 Code as amended in 1951, published in 26 C. F. R. 39.101(12)-39.101(12)-4, were continued by C. B. 1954-2, 47.

<sup>91</sup> Waas, Geo. J., and White, Daniel G., "APPLICATION OF THE FEDERAL INCOME TAX STATUTES TO FARMERS' COOPERATIVES, Bul. No. 53, p. 22, Farmer Coop. Serv., U. S. D. A. 1942.

<sup>92</sup> I. T. 2720, C. B. XII-2, 71.

<sup>93</sup> C. B. X-1, 150; *Garden Homes Co.*, 26 B. T. A. 441, 462, reversed on other grounds, 64 F. 2d 593.

<sup>94</sup> *Farmers Union Cooperative Company*, 33 B. T. A. 225, 229, affirmed in 90 F. 2d 488. See also *Council Bluffs Grape Growers Association*, 44 B. T. A. 152.

In another case the petitioner failed to prove that any of its members were producers or producers' marketing agents.<sup>95</sup>

The Internal Revenue Service has construed the exemption provision to include associations which take title to farm products as well as those which act strictly on an agency basis. In addition, the statutory language has been construed to include associations which process products by changing the form of the raw materials furnished by their producer members.<sup>96</sup>

It is the powers that are exercised by an association and not those possessed which are of controlling importance in determining its right to exemption.<sup>97</sup>

Moreover, an association engaged in the marketing of farm products and in the purchasing of supplies and equipment must with respect to each of these functions meet the requirements for exemption and it cannot engage in unauthorized activities.<sup>98</sup>

In the case last cited, the Tax Court held that a fruit growers' association which carried on as one of its principal activities the maintenance and care-taking of citrus groves did not qualify for exemption. It said this activity cannot qualify as "purchasing supplies and equipment for the use of members or other persons \* \* \*."

Substantially all the voting stock of an association must be owned by producers who market their products or purchase their supplies through the association. The Internal Revenue Service has said: <sup>99</sup>

It is impracticable to attempt to define the term "substantially all" as used in the statutes under discussion for the reason that what constitutes substantially all of the capital stock of a cooperative marketing association is a question of fact, which must be decided in the light of the circumstances surrounding each particular case. Any ownership of stock by other than actual producers must be explained by the association. The association will be required to show that the ownership of its capital stock has been restricted as far as possible to actual producers who market their products through the association. However, if by statutory requirement the officers of an association must be shareholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption; or if a shareholder for any reason ceases to be a producer and the association is unable, because of a constitutional inhibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that under such circumstances a small amount of the outstanding capital stock is owned by shareholders who are no longer producers will not destroy the exemption. On the other hand, where a substantial part of the stock was voluntarily sold to nonproducers, exemption must, under the statute, be denied as long as such stock is so held.

Where it appeared not only that 12 percent of the outstanding common stock of a marketing association was held by nonproducers but also that over 9 percent of such outstanding common stock was voluntarily sold or issued to persons who were not farmers or producers, "substantially all" the common stock was not owned by producers and the association was not entitled to exemption.<sup>1</sup>

In a certain case the Board of Tax Appeals said: <sup>2</sup>

Of the 213 shares outstanding in 1925, 194, or 91 percent, were held by persons

<sup>95</sup> *Cooperative Central Exchange*, 27 B. T. A. 17, 20.

<sup>96</sup> C. B. X-2, 164.

<sup>97</sup> C. B. III-1, 287; *Eugene Fruit Growers Association*, 37 B. T. A. 993.

<sup>98</sup> C. B. X-2, 164, 167; *Dr. P. Phillips Cooperative*, 17 T. C. 1002.

<sup>99</sup> C. B. X-2, 164. Of course, patrons of a stock association who do not own at least one share of stock, may not be counted as "shareholders," but represent "nonmember" business. *Producers Livestock Marketing Association of Salt Lake City*, 45 B. T. A. 325. Cf. *In re Temtor Corn & Fruit Products Co.*, 299 F. 326; *Schlaefly v. United States*, 4 F. 2d 195. The courts in these cases considered statutory language similar, but not identical, to the "substantially all" stock requirement.

<sup>1</sup> C. B. V-2, 71.

<sup>2</sup> *Farmers Cooperative Creamery*, 21 B. T. A. 265.

who were producing owners either directly or on a crop-share basis. Nineteen were owned by persons who were not producers during that year, but of these 19 individuals 7 had been producers when the stock was acquired and 1 was the widow of a former producer. Of the 194 shares 167, or 79 percent, were held by operating farmers and 27 by persons who operated their farms by tenant farmers and received a crop share (including dairy products).

In view of these facts, the Board held that "substantially all" of the voting stock of the corporation was held by producers.

The Board of Tax Appeals has held that: <sup>3</sup>

\* \* \* the farm owner who operates his farm by tenants on a crop-sharing basis is entitled to be called a producer. He risks his capital, furnishes seed and takes his chances on profits in much the same manner as he would were he to hire the work done for wages.

A marketing association which markets products *purchased* by members as distinguished from those *grown or otherwise produced*, must treat such marketing as nonmember business and is in violation of the exemption provisions because it is not treating nonmembers the same as members.<sup>4</sup> However, a marketing association which otherwise qualifies for exemption will not be denied such exempt status if it markets for members products furnished by nonmember producers under the following circumstances. The member must be legally bound to turn back to such producers the proceeds of the sale of their products, less necessary marketing expenses, and must furnish the association with evidence that such obligation has been met.<sup>5</sup> The value of the products marketed for such nonmembers must be classed as nonmember business and cannot exceed the value of the products marketed for the members, if the exempt status is to be preserved.

Dividends on capital stock may not, if an association is to be eligible for exemption, be fixed at a rate exceeding 8 percent per annum, or the legal rate of interest in the State of incorporation, whichever is higher. In this connection the following quotation is applicable: <sup>6</sup>

Admittedly, in this case \$27,140 of the outstanding capital stock of \$45,680 was issued as stock dividends and the shareholders paid nothing therefor. This fact alone bars the petitioner from claiming exemption from income tax; for after the declaration of the stock dividends, the stockholders were receiving from 12 to 18 percent per annum on the amounts invested by them.

It should be noted that the dividends referred to in the foregoing quotation were stock and not patronage dividends.

It is understood that under the practice of the Internal Revenue Service, if an association is unable to pay a dividend in one year, there is no objection to the difference being made up in the next or succeeding years provided the amount of such payments does not exceed the aggregate that might be paid for the number of years in question.

The accumulation and maintenance of a reserve required by State statute, or the accumulation and maintenance of a reasonable reserve or surplus for any necessary purpose, such as to provide for the erection of buildings and facilities required in business or for the purchase and installment of machinery and equipment or to retire indebtedness incurred for such purposes, will not destroy the exemption.<sup>7</sup>

<sup>3</sup> *Farmers Cooperative Creamery*, 21 B. T. A. 265. In view of this ruling, the Internal Revenue Service has taken the position (in an unpublished ruling) that a member of a cooperative who operates his farm on a crop-sharing basis is a producer only with respect to the portion of the crop he receives as his share.

<sup>4</sup> I. T. 3853, C. B. 1947-1, 42; *Dr. P. Phillips Cooperative*, 17 T. C. 1002.

<sup>5</sup> Rev. Rul. 55-496; I. R. B. 1955-32, 8.

<sup>6</sup> *Farmers Mutual Cooperative Creamery*, 33 B. T. A. 117, 125. See also *South Carolina Produce Association v. Commissioner*, 50 F. 2d 742.

<sup>7</sup> 26 C. F. R. 39.101(12)-1.



It is clear that reserves may be accumulated for what are essentially capital purposes. No reason is apparent why an association may not accumulate reserves for any necessary purpose, provided they are reasonable in amount; and, of course, there is no question but that an association may accumulate reserves which are required by State law. If reserves, other than those required by State statute, are regarded as excessive, this will operate to cause an association to lose its exemption. The reserves which are referred to in the statute include so-called valuation reserves which are made, among other things, for the purpose of meeting depreciation and obsolescence on plants and equipment.

Reserves for depreciation may be deducted from gross income by any corporation, including a cooperative, as they simply represent one of the costs of doing business. They must, however, be reasonable in amount and bear a fair relation to the purposes for which they are taken; otherwise, they will be unfair to the members who patronize the association in the year in question. Moreover, excessive depreciation is subject to disallowance, and, if disallowed, is taxable income.<sup>8</sup>

It appears to be recognized that an association may accumulate reserves for carrying it over poor years.<sup>9</sup>

It is believed that an association may invest reserves in a building to furnish a permanent home for the organization, and the fact that this is done through the medium of another corporation will not operate to deprive the association of its exemption.<sup>10</sup>

If the reserves of an association are reasonable in amount and for a necessary purpose, the fact that such reserves may be invested in Government bonds or other securities which yield a return to the association should not adversely affect the right of the association to exemption.<sup>11</sup>

Many cooperatives are largely capitalized through the accumulation and maintenance of reserves. Assuming that these reserves are reasonable in amount and for necessary purposes, there does not appear to be any objection to this procedure from the standpoint of qualifying under the exemption provision. However, it is a requirement for exemption that all patrons, including nonmembers, who through their patronage "contribute" to such reserves have apportioned to them their "contributions" to such reserves or, at least, that the cooperative maintain such permanent records of the patronage and equity interests of all members and nonmembers that such apportionment can be made. As explained below, these reserves must be "allocated" also, if they are to be claimed as an exclusion from income for tax purposes. In connection with this subject attention is called to the revolving-fund plan of financing<sup>12</sup> which is well adapted to the plan of capitalizing an association through reserves which are properly apportioned or allocated to the patrons.

In a case in which the court held that an association was not exempt from the payment of Federal income taxes, it was said: <sup>13</sup>

<sup>8</sup> *Railway Express Agency, Inc. v. Commissioner*, 169 F. 2d 193, affirming 8 T. C. 991, and holding that this cooperative, composed of various railroad companies, and organized on a basis which required it to pay to them all receipts over operating costs and expenses, was liable for income taxes on amounts representing excessive depreciation which it had taken on its property.

<sup>9</sup> C. B. III-2, 236

<sup>10</sup> C. B. III-2, 236. See also *Koon Kreek Klub v. Thomas*, 108 F. 2d 616. But see *West Side Tennis Club v. Commissioner*, 111 F. 2d 6.

<sup>11</sup> See *Niles v. Central Manufacturers' Mutual Insurance Company*, 252 F. 564.

<sup>12</sup> See *Revolving-Fund Plan of Financing*, p. 223; and also bylaw provisions, p. 323.

<sup>13</sup> *Farmers Cooperative Co. v. United States*, 23 F. Supp. 123.

In fact, under the bylaws which were in force at this time, there was no way in which nonmembers could acquire an interest in the surplus and reserve which had been created. Besides this, it appears that no account or credit was ever set up on the books with reference to patronage dividends attributable to the business done with nonmembers, and there was no basis upon which they could make a legal claim to share in the profits of the business which had been done with them. It is clear therefore that plaintiff did not comply with the condition of tax exemption, namely, that the association shall be organized and operated for the purpose of turning back to the "members or other producers" the profits or savings on the basis of the quantity or value of the business done with each of such persons.

Where the organization papers of an association did not provide that the association was liable to its patrons for net margins or savings made, it was held <sup>14</sup> that the association was not exempt and that those who might be entitled to patronage dividends did not have a legal interest therein until the declaration of such a dividend.

As previously indicated, in order that an association may be eligible for exemption, it must deal with member and nonmember patrons on the basis of substantial equality. It is immaterial how the difference in treatment between member and nonmember patrons of an association is brought about. For instance, one association paid a bonus to its member patrons but did not pay a bonus to its nonmember patrons and this operated to deprive the association of exemption.<sup>15</sup>

A cooperative which had adopted bylaws providing for the payment of patronage dividends only to its stockholders was held ineligible for exemption.<sup>16</sup> In its opinion in this case the Board of Tax Appeals said:

No patronage or other dividends except as above indicated were ever paid to stockholders or nonstockholders from the time the corporation was organized up to and including 1928. The only way that patrons of the corporation could participate in the profits of the business was by purchasing shares of stock in the corporation, after which they could participate only in such profits as accrued subsequent to the date they became shareholders. The petitioner has never set up on its books any credits or accounts payable in favor of nonstockholders representing the profits made on business done with them. No segregation is made on the petitioner's books as between stockholder and nonstockholder business and there is no way of determining from the records of the corporation the business done with nonstockholders for the year 1928 and also no way of making available to the nonstockholders any profits made on their business in 1928.

In a certain case <sup>17</sup> it was held:

If part of the proceeds of nonmembers' products is to be used to create or maintain a surplus and to make additions to the capital assets of the association, without allowing them a proportionate distributive interest in the permanent value contributed by such surplus accumulations or capital assets additions, it must be held that the association to that extent is being operated for profit to its members, as against nonmember patrons, and that it is not exempt from taxation.

The business of nonmembers may, of course, properly be made to carry its just share of operating expenses, actual depreciation of plant and equipment, and dividends on existing capital stock recognized by the revenue acts. But, if such business is also to be forced to bear part of the burden of accumulating other permissible surplus, and of making reasonable and necessary additions to what constitute or are equivalent to capital assets of the association, it is clear that this must be done in a manner that will permit no profit to inure to association members therefrom, on dissolution or otherwise, or else the association cannot remain exempt from taxation. Provision must at least have been made, by appropriate enabling action on the part of the association and by adequate protective entries on its books and records, for nonmembers in such a situation as is here involved to share ratably with members,

<sup>14</sup> *Farmers Union Cooperative Co. v. Commissioner*, 90 F. 2d 488, affirming 33 B. T. A. 225.

<sup>15</sup> *Producers Creamery Co. v. United States*, 55 F. 2d 104.

<sup>16</sup> *Farmers Union Cooperative Co. v. Commissioner*, 90 F. 2d 488, affirming 33 B. T. A. 225, 227.

<sup>17</sup> *Fertile Cooperative Dairy Association v. Huston*, 119 F. 2d 274, 277, affirming 33 F. Supp. 712.

in an ultimate liquidation of the association's assets, on the basis of their comparative contributions thereto.

Every association that desires to be exempt should give careful consideration to handling its reserves in a manner consistent with the requirements given in the foregoing quotations.

For an association which is engaged in doing business with members and nonmembers to be eligible for exemption, the association must keep records of the business done with both members and nonmembers.<sup>18</sup>

One association required its patrons to furnish satisfactory proof of their patronage for each year within 6 months after its close. In addition, the organization papers of the cooperative provided that failure to supply such proof absolved the association from further liability to a patron with respect to "profits" accruing during the year. For a taxable year during which the association "made sales of approximately \$30,000 to nonmembers and non-producers to whom no patronage dividends were paid or credited," it was held that the association was not exempt. The Board of Tax Appeals said:<sup>19</sup>

Obviously, some patrons, local as well as tourists and transients, paid a profit to petitioner, which, under the scheme, was not returned to them while other members and patrons received the benefits of such profit.

One court has said:<sup>20</sup>

Where one who is not a stockholder or a member is obliged to become a stockholder and a member in order to share in the profits of the association, we think it is obvious that the members and the nonmembers are not treated with that equality which is required in order that the association be entitled to the exemption.

As indicated, if an association is to be exempt from the payment of Federal income taxes, there must be no discrimination as between member and nonmember patrons. In this connection, however, the Internal Revenue Service has said:<sup>21</sup>

In other words, if products are marketed for nonmember producers the proceeds of the sales, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such proceeds result, whether or not such patrons are members of the association. Therefore, a cooperative marketing association may not, without losing its exempt status, make a profit on the business transacted with nonmember patrons and divert the proceeds of such business from the patrons entitled thereto. However, where a cooperative marketing association has otherwise complied with the provisions of the statute respecting exemption, but defers the payment of patronage dividends to nonmembers, exemption will not be denied—

1. Where the bylaws of the association provide that patronage dividends, by whatever name known, are payable to the members and nonmembers alike, and a general reserve is set up for the payment of patronage dividends to nonmembers.

2. Where the bylaws provide for the payment of patronage dividends to members, but are silent as to the payment of patronage dividends to nonmembers, and a specific credit to the individual account of each nonmember is set up on the books of the association.

3. Where the bylaws are silent as to the payment of patronage dividends to either members and/or nonmembers, but the evidence submitted shows that it has been the consistent practice of the association to make payment in cash or its equivalent of patronage dividends to members and nonmembers alike within a reasonable period after the expiration of the particular year involved.

4. Where, under the circumstances stated in 1, 2, and 3, above, patronage dividends are not payable until the nonmember becomes a member of the association either through the payment of the required amount in cash or the accumulation of dividends in an amount equal to the purchase price of a share of stock or membership.

<sup>18</sup> C. B. XIII-1, 77.

<sup>19</sup> *Central Cooperative Oil Association*, 32 B. T. A. 359.

<sup>20</sup> *Farmers Union Cooperative Supply Company of Stanton, Neb. v. United States*, 25 F. Supp. 93, 96.

<sup>21</sup> C. B. X-2, 164, 166.



It has long been the practice of the Internal Revenue Service to permit cooperatives to apply on the payment for a share of stock or for membership in an association the margins that accrue on the business of a nonmember.<sup>22</sup> Of course, such nonmembers should be producers in order to avoid having an association lose its right to exemption by reason of admitting nonproducers to membership.

Sometimes cooperatives have bylaws providing that if the savings on the business of a nonmember do not within a stated period of time, say 1 year, amount to the sum required for paying for a share of stock or for membership, the credit in favor of such nonmember shall be canceled and the amount in question carried to the general reserves of the association. Depending upon the par value assigned to the stock, such action might cost an association its exemption, because if more than nominal amounts are involved nonmembers would not be dealt with by the association on the same basis as members.

The Internal Revenue Service has ruled, however, that small patronage refunds of less than \$1 or the cents payable in excess of whole dollar amounts may be retained by an exempt cooperative without affecting its exempt status.<sup>23</sup> This same ruling also holds that:

Where a farmers' marketing and/or purchasing association issues either a certificate of stock representing a patronage dividend or a check representing a dividend payable on its stock, the mailing of either of such instruments to the patron would constitute payment for Federal income tax purposes in the year of issue, and such refunds will be allowed as deductions from gross income where, in the ordinary handling of the mail, delivery cannot be made and the association holds the instrument subject to the claim of the rightful owner.

Not only may an association be denied exemption because it does not deal with members and nonmembers on the same basis, but an association may be denied exemption because it does not maintain substantial equality among its members.<sup>24</sup>

If an association is handling a number of different commodities, on all of which net margins are realized, and elects to pay a patronage refund to the producers or purchasers of only one commodity, it is believed that this would deprive an association of its exemption, because of the inequality of treatment accorded to patrons.

As indicated, an association "may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members." However, inasmuch as the statute requires that an association must be organized for the "purpose of marketing the products of members or *other producers*" it is believed that an association may lose its exemption if it regularly purchases from dealers or on exchanges any substantial quantity of the commodities which it is engaged in handling.

Under some special conditions, it appears that an association may purchase agricultural commodities of the type which it is engaged in handling from others engaged in the same line of business without having this operate to deprive the association of its exemption.<sup>25</sup>

In a case in which it appeared that the cooperative had purchased "small quantities of poultry and eggs from dealers" as well as from producers in order to facilitate the marketing of the balance of the products which it handled by meeting contractual commitments, and the products

<sup>22</sup> C. B. XII-1, 122; C. B. XIII-1, 77.

<sup>23</sup> Rev. Rul. 55-141, I. R. B. 1955-11, 21. These amounts, unless reallocated to patrons on the basis of patronage, could be taxable to the cooperative.

<sup>24</sup> *Farmers Union Cooperative Oil Company*, 38 B. T. A. 64.

<sup>25</sup> C. B. II-1, 159.

which were so purchased were not handled at a profit, it was held that this did not operate to deprive the association of its exemption.<sup>26</sup> In another case,<sup>27</sup> the association, among other things being challenged by the Commissioner, sold ice and ice cream because it had found it necessary to the refrigeration of the association products to purchase an ice and ice cream factory operating upon property adjoining the cannery it operated, and the continuation of the ice and ice cream business reduced the refrigeration costs which would otherwise have been chargeable to the fruit marketing pools. Likewise, in order to utilize more effectively a machine shop which it ran as a necessary adjunct of a cannery, some custom work was done there on a commercial basis. None of the persons who purchased ice or ice cream or who patronized the machine shop shared in patronage refunds. Passing on this phase of the cooperative's activities, the Board of Tax Appeals said:

Looked upon as a whole it seems to us that these "commercial departments" were purely incidental to petitioner's principal purpose. They were conducted, not for their own sake, but as an adjunct and supplement to the cooperative marketing of farm products. See *Producers' Produce Co. v. Crooks*, 2 F. Supp. 969. This seems to us to be the test, and not the numerical percentage of petitioner's business attributable to those branches. It may be that the proportion of business done could be so great that it would be unreal to consider such operations incidental. Cf. *Hills Mercantile Co.*, 22 B. T. A. 114. On this point we need express no opinion, since in our view no such contention could prevail on the facts before us. The principle we have stated has been applied in construing other subsections of section 103 and similar provisions, and we see no reason to reach a different result here. *Santee Club v. White*, 87 Fed. (2d) 5; *King County Insurance Association*, 37 B. T. A. 288; *Trinidad v. Sagrada Orden de Predicadores*, 263 U. S. 578; *Unity School of Christianity*, *supra*; *Sand Springs Home*, 6 B. T. A. 198. And it is to be noted that there is no statutory requirement that petitioner be engaged "exclusively," in cooperative marketing, as there was in some of the provisions construed by those decisions, but merely that it be "organized and operated on a cooperative basis (a) for the purpose of marketing the products of members \* \* \*." We believe petitioner falls clearly within that definition.

One way of avoiding the effect of the restriction under discussion is to make all purchases other than from members or nonmember producers only from other farmer cooperatives, if this is feasible. Purchases from other cooperatives are considered in the category of purchases from "producers."

If an association buys commodities under special circumstances from nonmembers who are dealers, the question arises as to whether it must pay patronage refunds to such dealers on the same basis as it pays such refunds to patrons generally. The answer is, "No." Since a marketing cooperative should not ordinarily be making such purchases, they are not regarded as part of the cooperative's normal marketing operations.

A more difficult question, however, is what to do about the association's net margins, if any, on such transactions. If the association is able to establish that these transactions were handled at a loss or on a break-even basis, this would seem to furnish a clear justification for not paying a patronage refund to the dealer, and there is no problem as to the disposition of margins.<sup>28</sup>

In several unpublished cases, which occurred prior to the 1951 amendment, the Internal Revenue Service allowed "exempt" cooperatives to distribute savings on these dealer transactions among other patrons in pro-

<sup>26</sup> *Producers' Produce Company v. Crooks*, 2 F. Supp. 969.

<sup>27</sup> *Eugene Fruit Growers Association*, 37 B. T. A. 993.

<sup>28</sup> *Fertile Cooperative Dairy Association v. Huston*, 119 F. 2d 274, 277, affirming 33 F. Supp. 712.

portion to their patronage. They were in effect treated as "income not derived from patronage." Perhaps a good case could be made for concluding that they may still be handled in this way. However, there is an alternate method of handling which would seem less likely to be questioned by the Internal Revenue Service. This method is to exclude the amount of the savings on the transactions with dealers from funds allocated on a patronage basis and, if necessary because sufficient offsets are not available, pay a tax on them.

The term "supplies and equipment" has been construed to include "groceries and all other goods and merchandise used by a farmer in the operation and maintenance of a farm or farmer's household."<sup>29</sup>

If an association is owned and controlled by farmers, but a substantial percentage of them are not patronizing the association, this situation might raise a question as to the right of such an association to exemption because it will be remembered that the voting stock of an association must be "owned by producers who market their products or purchase their supplies and equipment through the association."

If an association, in addition to its marketing or purchasing activities, contemplates engaging in other lines of business on a commercial basis, careful investigation should be made to ascertain if this will affect the right of the association to exemption.

If an association processes the commodities which it receives from its members, and in such processing finds it necessary to add certain ingredients, it is believed that the purchase of such ingredients would not be regarded as nonmember business, if the chief function of the association is to market in processed form the commodities which it receives from its members.

Of course, the fact that a cooperative that is exempt acquires all the stock of another corporation does not alone operate to confer exemption on the latter corporation.<sup>30</sup>

The question whether an association is entitled to exemption is one to be determined solely by reference to the exemption provisions of the Federal statutes and the fact that an association is incorporated under the cooperative act of a State and operates in accordance therewith is immaterial.<sup>31</sup>

The fact that a cooperative which is eligible for exemption is carrying on through a subsidiary corporation certain activities and functions, which the association could not perform directly and retain its exemption, should not operate to cause an association to lose its exemption.<sup>32</sup>

For many years, the Internal Revenue Service has held that a federated type of cooperative is eligible for exemption. In a certain case<sup>33</sup> passed upon by the Service, it was said:

The principal members of the company are the local citrus growers' associations, which are cooperative, nonprofit corporations, without capital stock, whose members

<sup>29</sup> C. B. XII-2, 72; 26 C. F. R. 39.101 (12)-1. See also *Farmers Union Cooperative Association*, 44 B. T. A. 34.

<sup>30</sup> *Burr Creamery Corporation v. Commissioner*, 62 F. 2d 407, certiorari denied 289 U. S. 730, 53 S. Ct. 527, 77 L. Ed. 1479.

<sup>31</sup> *Farmers Union Cooperative Co. v. Commissioner*, 90 F. 2d 488, affirming 33 B. T. A. 225; *Farmers Cooperative Co. v. United States*, 23 F. Supp. 123.

<sup>32</sup> C. B. XII-1, 122. However, in an unpublished ruling, the Internal Revenue Service has said that an "exempt" cooperative cannot utilize reserves to own and operate a subsidiary engaged in activities in "which the cooperative itself could not engage in directly and be eligible for exemption."

<sup>33</sup> C. B. III-2, 233, 235. See also C. B. III-1, 290.



are the local fruit growers. Such a company is entitled to the same status as a company whose members are the farmers or the fruit growers themselves.

Even though an organization may in fact meet all requirements for exemption, such "exemption" is not automatic. It must obtain a "letter of exemption" by filing an application on Form 1028 with the District Director of Internal Revenue Service for the district in which its principal office or place of business is located. Once the letter is granted, it is not necessary to refile unless substantial changes are made in the organization or its activities. An association is required, however, to furnish information annually on Treasury Form 990-C, relating to its status as an "exempt" organization.

The Internal Revenue Service is not precluded from making an investigation of such an organization to determine if it is eligible, or, if not, the amount of its tax liability.<sup>34</sup>

Exemption continues only so long as the legal setup and the operating methods are in accord with the requirements of the applicable statutes and regulations. Thus a change in status can occur even though the letter of exemption is not withdrawn or canceled by the Internal Revenue Service.

If an association has been erroneously granted exemption, this ruling is not binding on subsequent Commissioners of Internal Revenue who may set the so-called exemption aside and then proceed to collect income taxes for the entire period in question.<sup>35</sup> In the case last cited, as no income tax returns had been filed the statute of limitations had not run.

It has also been held that the filing of Form 990<sup>36</sup> will not start the running of the statute, because it is not a tax return and does not supply adequate information from which the amount of tax, if any, can be determined.<sup>37</sup> It is believed, however, that Form 990-C, which is the tax return "exempt" farmer cooperatives must file, is sufficient. Accordingly, the filing of this form would start the running of the statute.<sup>38</sup>

Not only may an exemption which has been improperly allowed be set aside and the association be held liable for income taxes, but if the Service erroneously makes a refund to an association such refund may be recovered by the Government.<sup>39</sup>

For an organization which was exempt from the tax but subsequently became taxable, it is necessary in computing the gain or loss from the sale or exchange of property to reduce the basis by the amount of depreciation sustained with respect to the property for the period it was held while the taxpayer was exempt, as well as subsequently.<sup>40</sup>

Under the established practice of the Internal Revenue Service, exemption comes to an end on the day a cooperative ceases operations. Accordingly, even prior to December 31, 1951, if gains were realized on the sale of assets after the association had ceased to operate, the cooperative was required to file an income tax return and pay a tax if one was due.

Where a federated wholesale cooperative was composed in part of consumer cooperatives, it was held that it was not entitled to exemption.<sup>41</sup>

<sup>34</sup> *United States v. Stiles*, 56 F. Supp. 881.

<sup>35</sup> *Southern Maryland Agricultural Fair Association*, 40 B. T. A. 549.

<sup>36</sup> The information return required to be filed by "exempt" organizations after 1943.

<sup>37</sup> *Automobile Club of Michigan*, 20 T. C. 1033, affirmed, 230 F. 2d 585.

<sup>38</sup> For applicable statute, see 26 U. S. C. A. 6501-6533.

<sup>39</sup> C. B. XI-1, 223; *Producers Creamery Co. v. United States*, 55 F. 2d 104.

<sup>40</sup> C. B. 1952-2, 221. Since this ruling revoked C. B. XI-2, 105 (1932), which held to the contrary, it applies only to sales occurring in taxable years beginning after December 31, 1950.

<sup>41</sup> *Cooperative Central Exchange*, 27 B. T. A. 17.

Referring to these consumer cooperatives, the Board of Tax Appeals said:

There is nothing in the record to show that the petitioner's sales to such patrons were less than 15 percent of its total sales in the several taxable years. It follows, therefore, that in this respect the petitioner has failed to establish its claim for exemption.

Apparently, the Board, as shown by the following quotation, was inclined to question whether the cooperative would have been entitled to exemption even though all of the organizations composing it were farmer cooperatives that came within the exemption provisions of the statute:

We are not advised whether these concerns are marketing or purchasing agents or whether all or any of them combine both functions. Certainly there is no evidence that all the members of each of such organizations are producers of commodities that are marketed through the petitioner as their agent. Even if all the individual members of the farmers' cooperatives which enjoyed membership in the petitioner are producers, it does not follow that the organizations themselves are producers, or even agents of producers.

The statute provides that "Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption \* \* \*." In view of this provision, in any instance in which it has application, the business done by an association for the United States or any of its agencies will not adversely affect the right of the association to exemption. In order for the provisions to have application, however, the association must actually be doing business for the United States or one of its agencies. If an association is merely selling commodities to the United States or one of its agencies, this would not appear to be sufficient. On the other hand, the language would include an association engaged in the acquiring or selling of commodities for the United States or one of its agencies, in accordance with a contract authorizing the association to do so. Likewise, the storage of commodities by an association for the United States or one of its agencies would also appear to come clearly within the terms of the language. The provision has no application to a State or any subdivision thereof.

There is no such thing as partial exemption under the statute. In a certain case the Board of Tax Appeals said: <sup>42</sup>

In the first place, we find nothing in the governing statute which provides for a partial exemption from taxation of corporations of the character of the petitioner.

The failure to distinguish between the right to exemption and the right of a nonexempt association to exclude patronage dividends under proper circumstances has led to confusion and has induced the belief by some that there is such a thing as partial exemption. This is not the case.

### Taxation of "Exempt" Cooperatives

As previously stated, compliance with the various "exemption" requirements outlined and discussed above, no longer gives complete exemption from income tax.<sup>43</sup> It authorizes a complying association to apply section 522 of the Internal Revenue Code of 1954 in computing any taxable net income.

Under section 522, it is clear that any taxable net income of even an "exempt" cooperative is subject to normal, surtax and capital gains taxes imposed on corporations generally. In computing taxable income, an

<sup>42</sup> *Farmers Union Cooperative Oil Company*, 38 B. T. A. 64.

<sup>43</sup> An association qualifying under section 521 is exempt from the payment of a documentary stamp tax on the issue or transfer of shares or certificates of stock and certificates of indebtedness. 26 U. S. C. A. 4382 (a) (3).

"exempt" cooperative may take the usual business expense deductions and two other deductions: (1) Amounts paid during the taxable year as dividends on capital stock,<sup>44</sup> and (2) amounts paid to patrons, or allocated and disclosed to each patron, with respect to revenues not derived from patronage. The amounts covered by the second deduction include, for example, rents received, investment revenues, gain on the sale of depreciable property and capital assets, and amounts from business done with the United States Government.

Section 522 also states that patronage "dividends, refunds, and rebates to patrons" with respect to their patronage in the same or preceding years, and whether paid in cash or several noncash forms, shall be taken into account in computing any taxable net income "in the same manner as in the case of a cooperative organization" not exempt under section 521. Thus, the Congress expressly recognized that farmer cooperatives may exclude true patronage refunds from gross revenues in computing Federal income tax. A true patronage refund is a distribution by a cooperative of the excess margin over expenses which it is under a prior mandatory obligation to make to its patrons. This will be discussed in more detail in the next section.

Such patronage refunds may be excluded by an "exempt" cooperative if the allocation is made on or before the 15th day of the 9th month following the close of the taxable year in which the amounts allocated were received by the cooperative. The regulations make it clear that the prior mandatory obligation, referred to above, must exist. This obligation may be in the cooperative's organization papers, marketing agreements, or any other valid contractual form.<sup>45</sup>

### Taxation of Nonexempt Cooperatives

There is only one respect in which the computation of the taxable statutory net income of a cooperative corporation for Federal income tax purposes differs from a similar computation for a corporation not organized on a cooperative basis, if such cooperative corporation has not qualified for "exemption" under section 521 of the Internal Revenue Code.<sup>46</sup> Such a cooperative corporation may exclude from its gross income true patronage refunds for which it makes provision during the taxable year and which it distributes within a reasonable time after the close of the taxable year.

During congressional hearings in 1951, Thomas J. Lynch, General Counsel of the Treasury Department, was asked to furnish a memorandum on the Treasury's position with respect to the exclusion of patronage refunds from taxable income. The memorandum<sup>47</sup> he submitted was as follows:

A taxable cooperative is a cooperative other than a farm cooperative specifically exempt from income tax under section 101 (12) of the Internal Revenue Code. It is subject to the corporate tax. However, if a cooperative has agreed at the time of any sale to or purchase from its patrons to allocate or return to them any net proceeds of the current year in proportion to patronage, it can compute its tax only on the amount of its net proceeds which have not been so allocated or returned as "patronage dividends." It should be noted that, if only members of the cooperative

<sup>44</sup> Defined in the regulations as including "common stock (whether voting or nonvoting) preferred stock, or any other form of capital represented by capital retain certificates, revolving fund certificates, letters of advice, or other evidences of a proprietary interest in a cooperative association." 26 C. F. R. 39.101 (12)-3 (d).

<sup>45</sup> 26 C. F. R. 39.101 (12)-4 (a).

<sup>46</sup> See *McLean County Service Company and Champaign County Service Company*, 45 B. T. A. 1004.

<sup>47</sup> Hearings Before House Committee on Ways and Means, 82d Cong., 1st sess., on Revenue Revision of 1951, pt. 3, pp. 2858-2859 (1951).



may receive patronage dividends, the cooperative may not omit from gross income the portion of any distributions to members which represents profits from dealings with nonmembers.

This treatment of patronage dividends has been a long-established practice of the Bureau of Internal Revenue. Such treatment, at the time of its adoption, was based on the theory that amounts allocated or returned as patronage dividends represented a reduction in cost to the patron of goods purchased by him through the cooperative or an additional consideration due the patron for goods sold by him through the cooperative.

One of the earliest Bureau rulings on the matter was under the Revenue Act of 1913. That act exempted from the income tax mutual savings banks not having any capital stock represented by shares. However, it prescribed a rather different treatment for mutual fire insurance companies whose members made premium deposits to provide for losses and expenses. These insurance companies were not required to include in taxable income any portion of the premiums returned to their policyholders as so-called policy dividends. Income from other sources and premium payments retained by these companies for purposes other than the payment of losses and expenses and reinsurance reserves were, however, taxable. The Treasury by analogy adopted in 1914 a similar rule for farm cooperative associations which were not eligible for exemption under the 1913 act and permitted them to exclude patronage dividends from gross income. (See T. D. 1996.) The regulations under the 1916 act, like those under the 1913 act, provided that any cooperative association which could not qualify for the statutory exemption of farm cooperatives because it did not, as then required by the statute, act strictly as agent but purchased produce from members with a view toward selling it for gain, might nevertheless exclude from gross income all amounts paid to members on the basis of quantity of goods handled for them.

Treasury rulings consistent with the above have been issued during that period until the present time. Examples are T. D. 2737 (1918), IT 1499 (1922), IT 1566 (1923), GCM 12393 (1933), GCM 17895 (1937). The present tax treatment of patronage dividends thus represents the long-established administrative practice.

This practice has been recognized by the courts as valid. Examples of recent decisions are *Associated Grocers of Alabama v. Willingham*, 77 F. Supp. 990; *Peoples Gin Company v. Comm'r.*, 118 F. (2d) 72; and *Fountain City Co-op Creamery Association v. Comm'r.*, 172 F. (2d) 666. In an opinion which exhaustively reviews the administrative and judicial precedents in the matter, the District Court for the Northern District of Iowa concluded: "This practice \* \* \* has been recognized and approved by the courts." (86 F. Supp. 201, 238.) That court also specifically held:

"1. That the Treasury Department rulings providing that under certain conditions a cooperative may exclude from its gross income for Federal income tax purposes amounts allocated as patronage dividends are not so unreasonable or so plainly inconsistent with the Internal Revenue Code as not to be followed" (p. 237).

Moreover, it does not seem unimportant that during this long period of uninterrupted administrative practice, the Congress had not changed the rule by legislation, even though during a period of over 30 years it has often reenacted various revenue acts. It has been indicated by the Supreme Court that where there has been a contemporaneous administrative construction of a congressional enactment followed by long-continued administrative practice, reenactment "amounts to an implied legislative recognition and approval of the executive construction of the statute." (*National Lead Co. v. U. S.*, 252 U. S. 140.)

Farmer cooperative marketing and farm supply associations, whose by-laws set forth a definite preexisting obligation of the association to make distribution to patrons of a portion of net margins as patronage refunds, may exclude such refunds from income for Federal income tax purposes regardless of whether the corporate name contains the word "cooperative."<sup>48</sup>

The right to deduct patronage refunds as just outlined is not confined to farmer organizations. This also has been recognized by a spokesman for the Treasury and by the courts.<sup>49</sup>

<sup>48</sup> Rev. Rul. 55-26; I. R. B. 1955-3, 64.

<sup>49</sup> Statement by A. Lee M. Wiggins, Under Secretary of the Treasury, in hearings before the House Committee on Ways and Means, 80th Cong., 1st sess., pt. 4, p. 1881 (1947): "Under present law, farm cooperative associations are authorized to exclude patronage refunds from gross income. This, however, is not the exclusive privilege of cooperative associations. The privilege is available to any corporation which

One of the earliest cases establishing the principle in question is *Appeal of Paducah & Illinois Railroad Company*.<sup>50</sup> In that case a bridge company was organized and completely owned by several railroads. The bridge company borrowed \$5 million and built a bridge which was used jointly by the owning railroads. The company was obligated by contract to account to the several owners in preferred stock for any rates, tolls, and charges which the owners paid for using the bridge which were in "excess" of the pro rata shares of such owners for the operating and maintenance expenses of the bridge company. The "excess" was actually used to retire the bonds, for which the owners were also liable, and as bonds were retired a like amount of preferred stock was issued to the owning railroads. The net effect of this contractual arrangement was to make the bridge company operate essentially as a cooperative. Its operations for the year were adjusted to cost with any excess refunded to the patrons (the member railroads which used the bridge) in proportion to their use of the facility. The Board of Tax Appeals held that this resulted in no taxable income to the bridge company from the "excess" charges used as described above.

One of the leading cooperative tax cases firmly establishing the principle is *United Cooperative, Inc.*<sup>51</sup> This cooperative was capitalized, in part, out of net margins realized on current operations. It was under contractual obligation to account to its patrons for all amounts received by the cooperative over operating costs and expenses and amounts which the cooperative was permitted to pay as dividends on stock. Under its bylaws the cooperative had a mandatory obligation to return this excess amount in cash or stock. The Tax Court held that all amounts which the cooperative was under a mandatory obligation to return to its patrons in accordance with their patronage was excludable from gross income. Because the board of directors had discretion to determine the amount, if any, of dividends which would be paid on capital stock, the court said that net margins equal to the maximum permissible dividends under the bylaws were not subject to a mandatory obligation, and, therefore, were taxable to the cooperative.

Prior to this decision the Board of Tax Appeals had held that where an association in cooperative form had adopted a bylaw creating a definite liability on the part of the association to credit its patrons with net margins, the association was entitled to deduct such amounts in computing its income taxes.<sup>52</sup>

The Board of Tax Appeals had also held that where an association had an oral understanding that there would be paid to its stockholders in addition to the amount paid to them at the time of the delivery of their grain "an amount equal to the difference between such amount plus the cost of reselling the wheat, and the price at which the wheat was resold," this amount could be deducted in determining the income taxes of the association, although no patronage dividend had been declared and

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makes payments to its customers under the conditions prescribed by the Commissioner of Internal Revenue and the courts." See, also, the cases cited in the next note.

<sup>50</sup> *Appeal of Paducah & Illinois Railroad Co.*, 2 B. T. A. 1001; *Uniform Printing and Supply Co. v. Commissioner*, 88 F. 2d 75; *Clover Farm Stores Corp.*, 17 T. C. 1265; *Broadcast Measurement Bureau, Inc.*, 16 T. C. 988; *Southwest Hdwre. Co.*, 24 T. C. 75. Cf. *Railway Express Agency, Inc. v. Commissioner*, 169 F. 2d 193, affirming 8 T. C. 991.

<sup>51</sup> 4 T. C. 93 (1944).

<sup>52</sup> *Appeal of the Trego County Cooperative Association*, 6 B. T. A. 1275; *Anamosa Farmers Creamery Company*, 13 B. T. A. 907; *Farmers Union Cooperative Association*, 13 B. T. A. 969. In *Anamosa* the Board said: "In this situation neither the basis of accounting nor the fact that no cash was paid to the patrons in the taxable year is material."

although the amount in question "was eventually wiped out by operating losses."<sup>53</sup>

In one case, the board of directors of the association, within the fiscal year, had adopted a resolution under which part of the net margins was to be distributed on a patronage basis in cash and part in a patrons' equity reserve. The latter amounts were apportioned to patrons during the succeeding fiscal year. The action of the board was approved at the annual meeting of stockholders. The Board of Tax Appeals held that the amounts placed in the patrons' equity reserve were excludable from gross income.<sup>54</sup>

Later Tax Court and Federal court decisions make it clear, however, that the current rule is that only patronage refunds (or dividends, as they are sometimes called) actually distributed under a preexisting obligation either in the form of cash or by offset against a capital investment in, or loan to, the cooperative (evidenced by capital stock, certificates of indebtedness, notes, book credits or in some other manner which discloses to the patron the dollar amount of his interest) are excludable from gross income.<sup>55</sup>

To the contrary, where it does not appear that the organization papers or other contractual arrangements between the cooperative and the patrons create the required preexisting obligation, it has been held that the patronage refunds may not be excluded from gross income.<sup>56</sup>

As one author<sup>57</sup> has observed:

The cooperatives' income tax cases constituted a long course of administrative and judicial wallowing among various theories before the mandatory obligation and reinvestment theory was firmly established.

However tortuous the route, the principle as shown by the cases is now well established in the cooperative tax cases. It is aptly expressed by the Tax Court in *United Cooperatives, Inc.*<sup>58</sup> as follows:

The fact that member patrons were under obligations with regard to the purchase of petitioner's stock under certain circumstances and that petitioner had a right to apply a part of the "patronage dividends" to a satisfaction of such obligations, is immaterial. It does not affect the right of the member patrons to receive "patron-

<sup>53</sup> *Home Builders Shipping Association*, 8 B. T. A. 903. At p. 909 the Board said: "It is to our minds immaterial that the liability \* \* \* has not, as yet, been paid. There was no evidence that the petitioner never intended to pay it."

<sup>54</sup> *Midland Cooperative Wholesale*, 44 B. T. A. 824.

<sup>55</sup> *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201; *San Joaquin Valley Poultry Producers Association v. Commissioner*, 136 F. 2d 382; *Colony Farms Cooperative Dairy, Inc.*, 17 T. C. 688; *Dr. P. Phillips Cooperative*, 17 T. C. 1002; *Otsego County Cooperative Association, Inc.*, C. C. H. Dec. 19, 137 (M), Dkt. No. 28479, July 31, 1952, memorandum opinion by Judge Rice. If an association is under obligation to pay patronage dividends to its members only, it may not exclude amounts which it has made on business done with nonmembers, even though it distributes such amounts in the guise of patronage dividends to its members. C. B. III-2, 238. Cf. *Bakers Mutual Coop. Association v. Commissioner*, 117 F. 2d 27, affirming 40 B. T. A. 656; *Fruit Growers' Supply Co. v. Commissioner*, 56 F. 2d 90, affirming 21 B. T. A. 315.

<sup>56</sup> *Farmers Union State Exchange*, 30 B. T. A. 1051; *Juneau Dairies, Inc.*, 44 B. T. A. 759; *Cooperative Oil Association, Inc. v. Commissioner*, 115 F. 2d 666; *Peoples Gin Co. v. Commissioner*, 118 F. 2d 72, affirming 41 B. T. A. 343; *Associated Grocers of Alabama v. Willingham*, 77 F. Supp. 990; *Gallatin Farmers Co. v. Commissioner*, 132 F. 2d 706; *American Box Shook Export Association v. Commissioner*, 156 F. 2d 629, affirming 4 T. C. 758; *Fountain City Cooperative Creamery Association v. Commissioner*, 172 F. 2d 666, affirming 9 T. C. 1077. Cf. *Druggists' Supply Corporation*, 8 T. C. 1343; *Union Fishermen's Cooperative Packing Co. v. Earle (Same v. Maloney)*, 121 F. Supp. 373.

<sup>57</sup> Nieman, Multiple Contractual Aspects of Cooperatives' Bylaws, 39 Minn. L. Rev. 135, 136 (1955).

<sup>58</sup> 4 T. C. 93, 108.



age dividends," but merely constitutes a permanent directive as to their application. The result of the procedure set up by petitioner's bylaws was as if the stockholder member who was under obligation to purchase additional stock had received, in cash, the "patronage dividend" and had thereupon applied this sum to the payment of his stock. The stock, when thus paid and issued to him, was not in the nature of a stock dividend, but represented an additional investment on his part to the capital of the corporation out of his savings from the annual transactions with petitioner.

The fact that under this agreement the cooperative's directors have discretion to determine what portion of the net margins the patrons should invest in capital of the cooperative (be it stock, or certificates of interest or book equities in revolving fund capital) does not preclude the obligation to pay the patronage refund from being mandatory. Nor is it pertinent that the stock, certificates, or equities might not be redeemed until some future time; or that the farmer has put his money in a capital stock or other interest which may have no current fair market value.<sup>59</sup> The cooperative has performed the terms of its patronage contract when it allocates the patronage refund to the patron under its preexisting contract to make the distribution.<sup>60</sup>

It is sometimes difficult to work out a method by which an antecedent contract obligating the cooperative to distribute margins to patrons may be created. With respect to members of the cooperative, the State law, the articles and the bylaws constitute the contract among the members one with another and also between the members and the association. It is therefore possible to show that the contract exists by reason of the State law or, if that is not true, to create the necessary antecedent obligation by an appropriate provision in the articles or bylaws. With respect to both member and nonmember patrons marketing products through an association, it is also possible to create the necessary antecedent obligation in the marketing agreement. In both of these cases care must be taken that all members and all marketing patrons actually do execute some formal written instrument by which they become bound to the association and the association becomes bound to them to make patronage distributions.

Many cooperatives do a substantial business with nonmembers. It is always a most vexing problem to establish the necessary antecedent contract with such persons. Some cooperatives conspicuously post excerpts from the articles and bylaws in their place of business, others print the applicable excerpts on order blanks, sales receipts, advertising material and other communications between the patrons and the association. If such posters or printed material are properly worded and conscientiously posted or distributed, it is probable that the courts would hold that the cooperative had offered to do business with the nonmember patron on a cooperative patronage basis and that the patron had accepted this offer by doing business with the cooperative.

Some cooperatives follow the plan of making every patron a member at the time of the first transaction between the cooperative and the patron. In this case the patron is required to sign a membership application and agree that his first patronage dividends shall be applied on his membership

<sup>59</sup> It may appear unrealistic to some to say that the farmer has realized income of 100 cents on the dollar when his patronage refund is offset by an investment in stock or other capital interests which have no immediate fair market value. The farmer, however, has received the benefit of the service provided by his cooperative and who can say that this has not given him full economic value for his money. Moreover, income does not cease to be income because it has been invested or loaned, even though the investment or loan is a poor one. Cf. *Brown v. Commissioner*, 220 F. 2d 12.

<sup>60</sup> See cases cited in n. 55; *Nieman, op. cit. supra*, n. 57, at 143.

fee. This plan, if adhered to and if workable in the business of the cooperative concerned, accomplishes the purpose of making every patron a member.

Amounts authorized by members to be deducted from sales proceeds in the case of a marketing cooperative or to be added to the cost of purchases made for the express purpose of being used by the cooperative as capital also are not taxable to the cooperative.<sup>61</sup> This is because money furnished to any corporation for capital purposes is not income to the corporation.<sup>62</sup> Such amounts should not be confused with patronage refunds, since the contributions to capital from patronage refunds depend upon the existence of a net margin between a cooperative's gross receipts and its costs and expenses.<sup>63</sup>

In determining the net taxable income of a nonexempt cooperative, the Internal Revenue Service has ruled that, in the absence of evidence to the contrary, "the dealings with members and nonmembers are equally profitable."<sup>64</sup> The ruling just cited also shows how a cooperative's net taxable income is to be computed.

### Taxability of Patronage Refunds to Patrons

When this manuscript was prepared, the exact tax status of patronage refunds in the hands of patrons had not been clearly determined. Anyone with a specific tax problem should consult the current regulations of the Internal Revenue Service and also ascertain the current status of the court decisions. The following discussion may prove of historical interest, however, in tracing the development of this subject.

The Treasury, in 1953, for the first time included a section on this subject in its formal tax regulations.<sup>65</sup> These regulations were supplemented in 1954 by Rev. Rul. 54-10.<sup>66</sup>

The 1954 ruling reiterated the requirements of the regulations that all patronage refunds must be reported at their face amount if made in fulfillment of a valid preexisting obligation of the association to the patron, except where the patron's business income is not affected. It said that this was merely a reaffirmation of the policy of the Service "which had been long established."<sup>67</sup>

The ruling pointed out that this treatment is consistent "with the theory under which patronage dividends are treated by cooperative associations"; namely, "\* \* \* that the patron by express contract or by doing business with the cooperative agrees to allow the association to retain funds to which the patron is entitled. \* \* \* It is considered that the patron has in effect received in money the face amount of the document and has either rein-

<sup>61</sup> Rev. Rul. 54-244, I. R. B. 1954-26, 5.

<sup>62</sup> See *Edwards v. Cuba Railroad Co.*, 268 U. S. 628, 45 S. Ct. 614, 69 L. Ed. 1124; *Appeal of Paducah & Illinois Railroad Co.*, 2 B. T. A. 1001; L. S. Hulbert, *Money Received as Capital Is Not Income*, 10 *News for Farmer Cooperatives* 7 (Jan. 1943).

<sup>63</sup> See *Patronage Refunds*, *infra*.

<sup>64</sup> C. B. III-1, 287. See also *Farmers Union Cooperative Exchange*, 42 B. T. A. 1200, *Valparaiso Grain & Lumber Co.*, 44 B. T. A. 125. Cf. Rev. Rul. 54-297, I. R. B. 1954-31, 10. Where certain "wholesale" sales to nonmembers resulted in no profit, such sales were allowed to be excluded before profits were allocated between member and nonmember sales. *Producers Crop Improvement Association*, 7 T. C. 562.

<sup>65</sup> T. D. 6014, approved May 29, 1953; C. B. 1953-1, 110. For later form of this regulation see 26 C. F. R. 39.22 (a)-23.

<sup>66</sup> C. B. 1954-1, 24.

<sup>67</sup> For a listing and discussion of prior rulings of the Treasury, see Nieman, *Multiple Contractual Aspects of Cooperatives' Bylaws*, 39 *Minn. L. Rev.* 135, 151 (1955).

vested such amount in the capital of the association or allowed the association the use of the money. \* \* \*

The ruling recognized the problem presented by the fact that some patrons had failed to report the entire face amount, even though the regulations required such action. It established these rules: If the period of limitations has not expired, the face amount is reportable. If the period of limitations has expired, the difference, if any, between the amount reported in the year of allocation and the amount received on redemption is reportable in the year of redemption. An exception states that, where the Service has notice that the patron has failed to report the entire face amount of an allocation received in document form, after the statute of limitations has expired the Service will not insist that the excess over the reported amount be included in the patron's income in the year of redemption, except for that part of the excess which exceeds the face amount of the document.

Where an allocation was made which was not in pursuance to a preexisting agreement and the document issued was not a negotiable instrument, the amount received upon redemption, sale, or other disposition of the document should be included in gross income for the patron's taxable year in which received. It is assumed that this would apply to allocations of nonpatronage income by an "exempt" cooperative.

Where an allocation not pursuant to a preexisting agreement is a negotiable instrument, it is to be reported at fair market value unless the period of limitations has expired. In the latter case the difference between the amount reported in the year of allocation and the amount later received is reportable.<sup>68</sup>

The first case involving the taxability of refunds in the hands of patrons was decided by the Tax Court in 1950.<sup>69</sup> This case held that certain "credit memoranda" issued by a manufacturing cooperative were income to its accrual basis taxpayer when issued rather than when redeemed. A week later, the Tax Court held that accrual basis patrons of a dealers' wholesale grocery cooperative were required to include in their income, when received and at full face value, certain subordinated, registered notes of the cooperative which were not payable until liquidation although redeemable upon call by the cooperative's board.<sup>70</sup>

The first cash basis patron case to come before the Tax Court was decided in 1951.<sup>71</sup> The cooperative involved in the case was also before the Tax Court in a companion case<sup>72</sup> and the findings of the court in that case were incorporated in the patron's case. The court said:

The cooperative was under no obligation either to return the amounts to the members or to issue revolving fund certificates for the amounts it retained as a reserve from marketing operations. They belonged to and were taxable income of the cooperative. \* \* \* Dr. P. Phillips Cooperative voluntarily issued revolving fund certificates against the amounts retained from marketing operations. Those certificates had no fair market value and did not represent income to the petitioners on that basis. \* \* \*

The situation with respect to the amounts retained by the cooperative from its 1946 caretaking activities is different. It has been held in *Dr. Phillips Cooperative, supra*, that those amounts never belonged to the cooperative. It was required by

<sup>68</sup> For a dissenting view on the treatment to be accorded refunds not made pursuant to a preexisting obligation see the quotation from Nieman, *post*, p. 217.

<sup>69</sup> *Harbor Plywood Corporation*, 14 T. C. 158, affirmed, 187 F. 2d 734. For analysis of the theory of this and subsequent decisions mentioned here, see Nieman, *op. cit. supra*, n. 67, 155 *et seq.*

<sup>70</sup> *George Bradshaw*, 14 T. C. 162.

<sup>71</sup> *P. Phillips*, 17 T. C. 1027.

<sup>72</sup> *Dr. P. Phillips Cooperative*, 17 T. C. 1002.



its contracts with its members to issue revolving fund certificates for the funds thus retained. The members agreed in advance that those funds, which continued to belong to them, could be retained by the cooperative for the special purpose of the reserve.<sup>73</sup>

On this reasoning, the court held that Phillips was taxable in the year of issue on the face amount of the certificates issued in connection with caretaking activities but not on the certificates issued in connection with marketing operations. This case resulted in a consistent application of cooperative theory as to the status of patronage refunds both from the standpoint of the cooperative and the patron.

Other cases soon followed, however, and began to confuse the situation. In 1952 the Tax Court held in *Estate of Wallace Caswell*<sup>74</sup> that certain certificates, representing amounts retained by the association for a "commercial reserve" from the proceeds of peaches sold by the Caswell patrons, constituted income to them at the time of issue to the extent of their fair market value, and that the fair market value of these certificates was equal to their face value. Later, the Tax Court followed this case in holding that a taxpayer realized income upon the receipt of certificates of preferred stock from his cooperative to the extent of the fair market value of such certificates, which it determined to be equal to their par value.<sup>75</sup>

In 1953 the Tax Court held in *B. A. Carpenter*<sup>76</sup> that a cash basis taxpayer need not include in gross income the face amount of revolving fund certificates issued by a farmer cooperative at its option in lieu of cash and which were found to have no fair market value at time of issue. Later that year, a Federal district court in Iowa held that the plaintiff-patron was not taxable on credits in a "Reserve for General Contingencies" established by another cooperative which plaintiff patronized.<sup>77</sup>

Although the opinion in this case refers to the patrons' inability to get cash for its credits, examination of the cooperative's articles and bylaws and its directors' resolution creating the reserve indicates that it was not obligated to pay the patrons the money which was transferred to the reserve so that the issuance of credits must have been voluntary and there was nothing to indicate that they had a market value.<sup>78</sup>

On April 1, 1954, the Ninth Circuit Court of Appeals reversed the Tax Court's earlier decision in the *Caswell* case.<sup>79</sup> It held that the certificates issued by the cooperative were mere evidences of the patrons' contingent rights in the commercial reserve, which rights existed even without the issuance of the certificates. It further said that these rights were subject to the happening of certain contingencies, none of which had occurred. Accordingly, it said that the certificates did not constitute taxable income to the recipients to any extent whatever in the year of issue.

On the last day of that month the Tax Court again held that the recipient of certain "retain certificates" was taxable only on the fair market value of the certificates, and found that the certificates in question had no fair market value capable of being ascertained with reasonable certainty.<sup>80</sup> The court also found, however, under the bylaws there involved that the board

<sup>73</sup> *P. Phillips*, 17 T. C. 1027, 1029.

<sup>74</sup> 17 T. C. 1190, reversed, 211 F. 2d 693.

<sup>75</sup> *William A. Joplin, Jr.*, 17 T. C. 1526.

<sup>76</sup> 20 T. C. 603, affirmed, 219 F. 2d 635.

<sup>77</sup> *Farmers Grain Dealers Association of Iowa v. United States*, 116 F. Supp. 685.

<sup>78</sup> *Nieman, op. cit. supra*, n. 67, 164.

<sup>79</sup> *Estate of Wallace Caswell v. Commissioner*, 211 F. 2d 693.

<sup>80</sup> *Mary Grace Howey*, P-H1954 T. C. Mem. Dec. Par. 54, 125.

of directors had the power to "retain the funds whether or not they chose to issue the certificates." This suggests the absence of a prior mandatory obligation.

In an unreported oral opinion on June 30, 1954, in *Moe v. Earle* (Civil No. 7074) the United States District Court for the District of Oregon held that the taxpayer there involved realized no income "in the year in which such amounts were deducted from the sums of money payable to the plaintiffs for their fruit, or in the year in which such (revolving fund) certificates were issued to the plaintiffs," but implied that any cash subsequently received upon redemption of the certificates would be income to the taxpayer in the year of redemption. The amounts involved were specific retains from sales proceeds and not patronage refunds.

On March 2, 1955, the United States Court of Appeals (Fifth Circuit) affirmed the earlier Tax Court opinion in *B. A. Carpenter*.<sup>81</sup>

Finally, on October 28, 1955, *Moe v. Earle* was affirmed by a *per curiam* opinion, and, on April 9, 1956, the Supreme Court of the United States denied certiorari.<sup>82</sup>

As this is written, there are three views as to the patron's tax responsibility:

1. The position of the Internal Revenue Service, as stated above, is that all non-cash allocations of a farmer cooperative's net margins made to a patron pursuant to a prior mandatory obligation must be taken into account in computing gross income of such patron in the year in which the patron is notified of the apportionment, except where they do not affect his business income.

2. The Tax Court has held in several cases that such allocations should be taxed at the fair market value of the document or credit received, and one of these decisions has been affirmed by the United States Court of Appeals (Fifth Circuit).

3. The United States Court of Appeals (Ninth Circuit) has said that such allocations are not taxable at the time evidence thereof is issued to the cooperative patron. Presumably, by implication, the patron would be taxed only if and when he receives cash in redemption of such allocations or retains. A Federal district court in Oregon has applied the same rule to capital retains from the proceeds of the sold crop, even though the patrons in advance of delivery of the crop had authorized the cooperative to make such retains. This decision has been affirmed by the United States Court of Appeals (Ninth Circuit) and the Supreme Court has allowed this decision to stand.

One author has suggested that this confusion can and should be eliminated by a return to the fundamental concepts and principles of cooperation developed in the cooperative tax cases.<sup>83</sup> If this were done, the applicable rules would be these:

Where the "patronage contract" precludes the cooperative from ultimately diverting the net margins to its stockholders or members as such, it would seem that it obligates the cooperative to pay them to its patrons. In such cases, the patron's authorization to the cooperative to invest his net margins in capital stock or some other kind of capital for him and to issue to him shares of stock or interests in the nonstock capital in performance of its obligation to pay him his net margins is, in substance and effect, a reinvestment for and by the patron. His income from such a transaction should be measured by the *face* value of his investment interest.

On the other hand, if the cooperative is free to pay the net margins to its members or stockholders, but if it nevertheless does pay them to its patrons in a noncash "investment contract" which the patron was not previously entitled to receive or obligated to accept, then the cooperative's payment is voluntary. The measure of the patron's income should be the *market* value of his investment interest without regard to the negotiable or nonnegotiable character of the piece of paper issued as convenient evidence of that interest.

<sup>81</sup> *B. A. Carpenter v. Commissioner*, 219 F. 2d 635.

<sup>82</sup> *Moe v. Earle*, 226 F. 2d 583, cert. den. 76 S. Ct. 657.

<sup>83</sup> Nicman, *op. cit. supra*, n. 67, 164-166.

## Corporations Organized to Finance Crop Operations

Paragraph (16) of section 501 (c) of the Internal Revenue Code of 1954<sup>84</sup> provides for exemption from Federal income tax of certain corporations set up for the purpose of financing crop operations by organizations which qualify under section 521. It reads as follows:

(16) Corporations organized by an association subject to part III of this subchapter or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, on dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

## Mutual Insurance Companies or Associations

Farmers' mutual insurance companies or associations meeting the provisions set forth in paragraph (15) of section 501 (c) of the Internal Revenue Code of 1954<sup>85</sup> may qualify for exemption. The paragraph reads as follows:

(15) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed \$75,000.

## Patronage Refunds

**W**HAT are patronage refunds? Originally they were called patronage dividends, but the trend now is to call them refunds. Actually they are not dividends at all in the sense in which the term is ordinarily employed, but are savings. The aim of a cooperative, whether marketing or purchasing, is to operate on a cost basis, or as near thereto as practicable. Patronage refunds are simply a means of enabling associations to achieve this result more easily.<sup>86</sup>

As a Federal district court stated it, in one case: <sup>87</sup>

\* \* \* Since October 24, 1844, \* \* \* the so-called Rochdale principles have been recognized. \* \* \* While these principles have been variously stated by different authorities, they all agreed upon the inclusion therein of the principle that distribution of the surplus originating in the economic activity of an organization is in direct proportion to the participation of members \* \* \*.

Accordingly, he said:

The patronage dividends to be paid to producers in a farmers' cooperative need not and should not be the same to every patron.

Patronage refunds were held in a Mississippi case not to be a part of

<sup>84</sup> 68A Stat. 165; 26 U. S. C. A. 501 (c), (16).

<sup>85</sup> 68A Stat. 165; 26 U. S. C. A. 501 (c), (15).

<sup>86</sup> Adcock, PATRONAGE DIVIDENDS: INCOME DISTRIBUTION OR PRICE ADJUSTMENTS, 13 LAW & CONTEMPORARY PROBLEMS 505 (1948); Jensen, THE COLLECTING AND REMITTING TRANSACTIONS OF A COOPERATIVE MARKETING CORPORATION, 13 LAW & CONTEMPORARY PROBLEMS 403 (1948).

<sup>87</sup> *Bowles v. Inland Empire Dairy Association*, 53 F. Supp. 210, 216.



the gross income of the cooperative, as it was obligated to return these amounts to the persons to whom they were paid.<sup>88</sup>

In general, any business concern, whether cooperative or otherwise, may pay patronage refunds. Statutes ordinarily bar the payment of refunds or rebates by railroads and public utilities, but those engaged in private businesses may ordinarily make such payments so long as they do not conflict with the contract rights of shareholders.<sup>89</sup> In a case arising in Oklahoma, the proprietor of a commercial cotton gin opposed the granting of a license to a cooperative that desired to engage in the cotton ginning business because, he contended, the cooperative was specifically authorized to pay patronage refunds by the statute under which it was incorporated, while he was barred from doing so. The commercial operator, therefore, contended that he was denied the equal protection of the laws. The Supreme Court of the United States found, however, that inasmuch as no law or regulation of the State had been adduced, which prohibited the commercial operator from the payment of patronage refunds, no discrimination was involved.<sup>90</sup> Patronage refunds are dependent on the success of the enterprise and are subject to its hazards. They should be distinguished from rebates.<sup>91</sup>

The need for using patronage refunds arises principally, if not solely, in associations that have a fixed schedule of charges for the handling of products and associations that pay at the time of receipt for products to be handled. For instance, some cooperative elevators have a fixed charge per bushel for the marketing of the grain they handle, generally the same as the going rate charged by private operators, whereas others aim to pay the current price therefor. In each case it is contemplated that at the end of the year, or of a fixed period, the expenses and costs of operation of the association will be ascertained and that the amount remaining will be distributed among the members on the basis of the quantity of product, or the value thereof, marketed by the association for each of them.

When associations have a schedule of charges, it is contemplated that the returns therefrom will more than cover all expenses of the association, but obviously it is unknown in advance what the exact amount of the expenses will be. Likewise, in the case of associations that pay the current price for the products handled, it is contemplated that the products will be sold for prices that will leave a balance after meeting all expenses; but the amount of this balance also is unknown in advance. At the end of the year, or of a fixed period, the expenses of the association are ascertained; and this amount, together with any other deductions such as for working capital or reserves, is subtracted from the total amount which has been received by the association for handling charges or from the total sale price of the product. The balance, or such portion thereof as the board

<sup>88</sup> *State v. Morgan Gin Company*, 186 Miss. 66, 189 So. 817. See also *Gallatin Farmers Co. v. Shannon*, 109 Mont. 155, 93 P. 2d 953; *Uniform Printing and Supply Co. v. Commissioner*, 88 F. 2d 75.

<sup>89</sup> But see *Midland Cooperative Wholesale v. Ickes*, 125 F. 2d 618.

<sup>90</sup> *Corporation Commission of Oklahoma v. Lowe*, 281 U. S. 431, 50 S. Ct. 397, 74 L. Ed. 945. See also *Guthrie Cotton Oil Co. v. Farmers' Custom Gin*, 156 Okla. 16, 9 P. 2d 32; *Southwestern Cotton Oil Co. v. Farmers' Union Coop. Gin Co.*, 165 Okla. 31, 24 P. 2d 658; *Chickasha Cotton Oil Co. v. Cotton County Gin Co.*, 40 F. 2d 846, 74 A. L. R. 1070; *Choctaw Cotton Oil Company v. Corporation Commission of Oklahoma*, 121 Okla. 51, 247 P. 390.

<sup>91</sup> Bunn, Charles. CONSUMERS' COOPERATIVES AND PRICE FIXING LAWS. 40 Michigan Law Review 2-165, 1941; *Certified Grocers of California, Ltd. v. State Board of Equalization*, 100 Cal. App. 2d 289, 223 P. 2d 291; *Eaton v. Brock*, 124 Cal. App. 2d 10, 268 P. 2d 58.

of directors of the association deems advisable, is then returned to the patrons of the association on the basis of the volume, or of the value, of the products each marketed through the association.<sup>92</sup>

It is apparent, therefore, that patronage refunds are a means of returning to patrons savings effected by cooperatives in marketing their products or purchasing their supplies. Manifestly, this is fundamental to cooperation, because there would be less incentive to cooperate if the savings effected in marketing expenses, or otherwise, could not be returned to patrons. Patronage refunds are based primarily upon products delivered and sold or upon purchases made and not upon the money invested.

The amount of the patronage refunds to which a patron is entitled is ascertained, by some associations, in substantially the following manner: The total amount available for distribution among the patrons at the end of the year or other period is determined. This amount is then divided by the volume of business handled by the association in terms, for instance, of cars, bushels, pounds, head, or the value of the product handled in dollars, or the amount paid to the association as handling charges. The figure thus found, when multiplied, for example, by the number of bushels handled for a given member, gives the amount of his patronage refund.<sup>93</sup> In other associations the patronage refunds are ascertained by dividing the total amount available for distribution by the total sale price of the products handled and then multiplying the resulting percentage by the price received for the products of each patron.

Patronage refunds, it may be assumed, would not be paid in many instances if, at the time the members of an association delivered their products to it or at the time of their sale, the association knew the exact amount it would cost to market the products of its members and provide for expansion purposes. It is apparent that patronage refunds are the result of necessity, in many instances at least, and that they simply furnish a medium by which the undertaking of the association to operate on a cost basis, or as near thereto as possible, may be carried out.

A novel case involving patronage refunds arose in Kansas<sup>94</sup> in which the plaintiff, who was not only a farmer and a stockholder in the defendant corporation but was also engaged in the grain business, was held not to be entitled to patronage refunds on grain that he had purchased from the corporation, but that the other shareholder patrons were entitled to the amount involved. The statute of Kansas under which the elevator company was incorporated, provided that, after the payment of a fixed dividend upon stock, the remainder of its earnings should be prorated to its several stockholders upon the basis of their purchases or sales, or on both. The court was of the opinion that the purchase by the plaintiff of grain from the elevator on a commercial basis was not such a purchase as was contemplated by the statute and, hence, that he was not entitled to patronage refunds.

The Grain Futures Act of September 21, 1922,<sup>95</sup> provides that the Secretary of Agriculture may designate any board of trade as a "contract market," if among other things—

the governing board thereof does not exclude from membership in, and all privileges on, such board of trade, any duly authorized representative of any lawfully formed and conducted cooperative association of producers having adequate financial re-

<sup>92</sup> Sometimes the distribution is only among patrons who are members. In such case, only that part of the distribution which represents the margins on the member business is a true patronage refund.

<sup>93</sup> *Mooney v. Farmers' Mercantile & Elevator Co.*, 138 Minn. 199, 164 N. W. 804.

<sup>94</sup> *McClure v. Cooperative Elevator & Supply Co.*, 105 Kan. 91, 181 P. 573.

<sup>95</sup> 42 Stat. 998, 1000, 1001.

sponsibility which is engaged in cash grain business, if such association has complied, and agrees to comply, with such terms and conditions as are or may be imposed lawfully on other members of such board: *Provided*, That no rule of a contract market shall forbid or be construed to forbid the return on a patronage basis by such cooperative association to its bona fide members of moneys collected in excess of the expense of conducting the business of such association.

The Supreme Court of the United States, in passing upon and upholding the constitutionality of the Grain Futures Act,<sup>96</sup> referred particularly to the paragraph of the statute in part quoted above and said:

Nor do we see why the requirement that the relation between them and this representative, looking to economy of participation on their part by a return of patronage dividends, should not be permissible because facilitating closer participation by the great body of producers in transactions of the Board which are of vital importance to them. It would seem to make for more careful supervision of those transactions in the national public interest in the free flow of interstate commerce.

The State of Kansas passed a statute<sup>97</sup> requiring boards of trade in that State which were not operating under the Federal Grain Futures Act to admit cooperatives. This act specifies that the making of refunds by a cooperative shall not be a cause for exclusion. This statute was passed upon and upheld by the Supreme Court of Kansas,<sup>98</sup> and in the opinion the court said:

The sole objection is that plaintiff sees fit to distribute its profits in a manner objectionable to defendant. One is tempted to inquire: What concern is it of defendant what plaintiff does with its profits, whether it retains them for additional working capital, or disburses them to its stockholders? And if it does disburse them to its stockholders, why should defendant be concerned with the basis of such disbursement, so long as it is satisfactory to plaintiff and its stockholders, and in conformity with the statute under which it was created? It may be doubted whether plaintiff's method of disbursing profits is correctly construed as a violation of defendant's bylaws against rebating or refunding commissions.

The Packers and Stockyards Act, 1921,<sup>99</sup> recognizes the right of cooperative livestock market agencies to pay patronage refunds to their producer members. This statute was upheld by the Supreme Court of the United States.<sup>1</sup> The Robinson-Patman Act permits associations of producers or consumers to pay patronage refunds.<sup>2</sup> In addition, there are certain other Federal statutes which recognize the right of cooperatives to pay patronage refunds.<sup>3</sup>

Where a marketing agreement obligated a grower to deliver a certain percentage of his products to an association and the bylaws provided that patronage refunds were payable only to those growers who fulfilled their marketing contracts, a grower who failed to deliver the required percentage of his crop was not entitled to receive a patronage refund.<sup>4</sup>

A nonmember patron of an association cannot compel it to pay him patronage refunds where its organization papers and procedure do not provide for doing so.<sup>5</sup>

<sup>96</sup> *Board of Trade of the City of Chicago v. Olsen*, 262 U. S. 1, 43 S. Ct. 470, 67 L. Ed. 839.

<sup>97</sup> Laws of Kansas 1925, ch. 6.

<sup>98</sup> *Farmers' Coop. Commission Co. v. Wichita Board of Trade*, 121 Kan. 348, 246 P. 511, 513, 54 A. L. R. 295, writ of error dismissed in 275 U. S. 574, 48 S. Ct. 17, 72 L. Ed. 433.

<sup>99</sup> 42 Stat. 159, 7 U. S. C. A. 181.

<sup>1</sup> *Stafford v. Wallace*, 258 U. S. 495, 42 S. Ct. 397, 66 L. Ed. 735, 23 A. L. R. 229.

<sup>2</sup> *Quality Bakers of America v. Federal Trade Commission*, 114 F. 2d 393.

<sup>3</sup> See Federal Statutes Mentioning Cooperatives, p. 247.

<sup>4</sup> *Rusconi v. California Fruit Exchange*, 101 Cal. App. 750, 281 P. 84.

<sup>5</sup> *Farmers Truck Association v. Strawberry & Vegetable Auction, Inc.*, 163 So. 181 (La. App.).



In two cases decided by the Supreme Court of Arkansas, it was held that nonmember tenants and sharecroppers of a landlord member of a cooperative gin were entitled to a share of the patronage refunds paid by the gin to the landlord.<sup>6</sup> Both suits were against the landlords, but the court lay great stress on the fact that the organization papers of the gin required it to treat all patrons, members and nonmembers, alike in the distribution of patronage refunds. The court said, in part:

The making of such payments results in a refixing and reduction of the original charge for ginning and a corresponding increase in the net proceeds derived from the sale of cotton. The fact that the legal title to the cotton was in appellant does not lessen his obligation to pay over to appellees one-half of such net proceeds under the terms of their contract. In the absence of a stipulation in the contract to the contrary, appellees were, therefore, entitled to share equally with appellant in the patronage payments; \* \* \*.<sup>7</sup>

As pointed out in the discussion regarding the liability of associations for Federal income taxes<sup>8</sup> an association cannot qualify for "exemption" unless it deals with nonmembers on the same basis as that on which it deals with members. If such an association pays patronage refunds to its members it must likewise pay such refunds to its nonmember patrons.

It is a fact frequently overlooked that virtually all persons who carry life insurance in a mutual company receive what amounts to patronage dividends or refunds.<sup>9</sup> It is true that these dividends are not referred to as patronage dividends, but in essence they are practically the same thing. The undertaking of a mutual insurance company may be said to contemplate the furnishing of insurance on a basis that will enable it to meet all of its obligations, including current and prospective expenses incident to maintaining and operating the company. At the end of a year or other period it is the practice for mutual insurance companies to ascertain the amount of the items referred to (due consideration being given to the risks and hazards involved) and then to return to the patrons or policyholders sums of money called dividends which are based upon the amounts paid by the policyholders and found unnecessary for the purposes specified. An insurance company cannot determine in advance the precise amount which should be charged for insurance to cover the items in question, nor can a cooperative determine in advance the precise amount necessary to meet its expenses and any other necessary charges. The insurance companies charge enough for the insurance to cover all possible contingencies, with the idea of returning any surplus to policyholders at the end of a given period. Cooperatives follow a like practice.

It has been said that—

So-called dividends upon life insurance policies are not really "dividends," but are the return by a mutual company of the unearned portion of the premium for the past year, unearned because of saving in expected mortality, saving in expense loading, and increase in investment earnings over the expected 3½ percent. To the extent of the combined savings due to these three elements, theoretically at least, the premiums paid in advance are regarded as having been excessive or unearned.<sup>10</sup>

There is no magic or mystery about patronage refunds; they simply represent a practical means of achieving a given result, namely, the return to the members of an association of savings effected by it.

<sup>6</sup> *Houck v. Birmingham*, 217 Ark. 449, 230 S. W. 2d 952; *Collie v. Coleman*, 223 Ark. 206, 265 S. W. 2d 515.

<sup>7</sup> *Houck v. Birmingham*, *supra*, at 955.

<sup>8</sup> See Federal Income Taxes, p. 195.

<sup>9</sup> *Williams v. Union Central Life Insurance Co.*, 291 U. S. 170, 54 S. Ct. 348, 78 L. Ed. 711, 92 A. L. R. 693.

<sup>10</sup> *Atlantic Life Insurance Company v. Pharr*, 59 F. 2d 1024, 1026.

Inasmuch as the amount of patronage refunds arises either from "underpayments" by marketing cooperatives or "overpayments" to farm supply cooperatives, after operating costs and expenses have been deducted, it is clear that there is no basis for the payment of a patronage refund on account of current operations unless an association actually has a net margin available for distribution to its patrons. It should be remembered that directors of an association act at their peril in authorizing the payment of refunds of any character unless the facts justify doing so.<sup>11</sup>

At common law the declaration of a dividend, whether patronage or otherwise, is a matter for action by the board of directors and not by the stockholders.<sup>12</sup> But bylaws could provide for referring this matter to the members.<sup>13</sup>

In the absence of specific agreement or conditions to the contrary, dividends, whether patronage or otherwise, do not constitute a liability of an association until declared.<sup>14</sup> Following the declaration of a dividend it represents a debt of the corporation.<sup>15</sup>

## Revolving-Fund Plan of Financing

THE problem of how equitably to capitalize a cooperative so that the capital furnished by a particular member will bear a direct relation to his patronage and ultimately will be returned to him is believed by many competent cooperative leaders to be solved best through use of the revolving-fund plan of financing.<sup>16</sup>

Many cooperatives have begun business with a small amount of capital, which has been gradually increased from deductions or savings without giving to the respective patrons a clearly defined contingent right with respect to the sums that each by reason of his patronage has provided. Frequently, the early patrons of an association are largely responsible for building up its capital, while those who later become its patrons are not required to make comparable investments therein. Such inequalities are avoided by the revolving-fund plan of financing.

Broadly speaking, this plan is one under which, after sufficient capital has been accumulated to justify doing so, money supplied by current patrons or others for capital purposes is used to retire the oldest outstanding investments of patrons or others in its revolving fund.

In marketing associations, under this plan, money for capital purposes is obtained principally from retains or deductions on a percentage or a unit basis, or from the sale of certificates of various kinds. In farm supply associations, the major part of the capital is usually obtained from savings. Such associations, instead of paying out patronage refunds in cash, pay them

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<sup>11</sup> *Fawkes v. Farm Lands Investment Company*, 112 Cal. App. 374, 297 P. 47; *Ellis v. French-Canadian Cooperative Association*, 189 Mass. 566, 76 N. E. 207; *Towles v. South Carolina Produce Association*, 187 S. C. 290, 197 S. E. 305; *Doss v. Farmers Union Coop. Gin Co.*, 173 Okla. 70, 46 P. 2d 950.

<sup>12</sup> *Callaway v. Farmers Union Cooperative Association of Fairbury*, 119 Neb. 1, 226 N. W. 802.

<sup>13</sup> *Ibid.*, No. 12.

<sup>14</sup> *Fruit Growers' Supply Company v. Commissioner*, 56 F. 2d 90, affirming 21 B. T. A. 315.

<sup>15</sup> II FLETCHER CYCLOPEDIA CORPORATIONS, Perm. Ed., sec. 5365.

<sup>16</sup> Sanders, S. D. "RETAINS" THAT NOBODY FEELS. 3 News for Farmer Cooperatives 5-6. Farmer Coop. Serv., U. S. D. A. 1936; Sanders, S. D. ORGANIZING A FARMER'S COOPERATIVE. Farmer Coop. Serv., U. S. D. A. Circ. 18, 39 pp. 1956; Nieman, REVOLVING CAPITAL IN STOCK COOPERATIVE CORPORATIONS, 13 LAW & CONTEMPORARY PROBLEMS 393 (1948).

by offset against the obligation of each patron to invest in the capital of the association.<sup>17</sup> The resulting investment is evidenced by stock, some form of certificate of interest, or a book credit.

The derivation of the name "revolving-fund plan" becomes more apparent when an association reaches the stage when the oldest investments of the patrons of previous years may be retired. It is only when an association reaches this stage that its revolving fund begins to revolve. Money which is thus furnished by the patrons of an association for capital purposes should be regarded by them as an investment in their own association and not as an additional expense. It cannot be overemphasized that it takes money to go into business. Farmers, when they form and operate a cooperative, are in business and should supply the required capital.

There is a wide latitude with respect to the terms and conditions which may be adopted for the revolving-fund plan of financing.<sup>18</sup>

Accumulations or retains for capital purposes, under this plan of financing, should be at least recorded on the books of the association as credits in favor of the proper persons. Generally, associations issue certificates to evidence such funds. These certificates are sometimes referred to as "certificates of indebtedness," "revolving-fund certificates," "certificates of equity," or "certificates of interest." The terms and conditions of such certificates differ and the rights of the holders vary accordingly.

Some associations organized with capital stock issue "certificates of stock" to evidence investments that increase the revolving fund. From a legal standpoint there appears to be no reason why an association formed with capital stock, as well as one formed on a nonstock basis, may not issue certificates other than certificates of stock. If an association revolves its capital stock, at least one share of voting stock should be held at all times by producers who are to continue as members of the association. If an association is formed with common and preferred stock, the preferred may be revolved while the common—usually issued on the basis of one share to each producer—would not be affected.

If an association is to employ the revolving-fund plan of financing, its organization papers should clearly show how it is intended to function; nothing should be left to surmise or inference. If it is intended that interest be paid on such capital funds, definite provision should be made therefor. In some instances it is preferred to make the payment of interest optional with the board of directors and to provide only that interest may not exceed 6 percent per annum. It is believed that, as a rule, the certificates issued should not have due dates and should be subject to retirement only at the discretion of the board of directors. If such certificates have due dates, the status as capital of funds which they represent is at least somewhat impaired, because ordinarily a suit may be brought against the association by the holder of such a certificate just as in the case of any other legal claim.

It is believed to be the better practice for an association to acquire and maintain contingency reserves for the purpose of "insuring" that certificates issued or credits given for funds obtained for capital purposes will remain

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<sup>17</sup> The practice of setting off the cooperative's obligation against the patron's obligation is frequently referred to as paying the net margins "in" stock or some other noncash form. The use of this "shorthand" way of speaking has tended to obscure the actual character of the transactions and the legal theory underlying them. It undoubtedly has contributed to some unsound analysis and thinking on the part of many people, especially those unfamiliar with the cooperative method of doing business. See, Nieman, *MULTIPLE CONTRACTUAL ASPECTS OF COOPERATIVES' BYLAWS*, 39 Minn. L. Rev. 136, 143 (1955).

<sup>18</sup> For suggested forms of bylaw provisions, see pp. 317-325.



at par. Such reserves are, of course, expected to operate as a cushion to absorb losses which an association may suffer. Reserves which are set aside for the meeting of contingencies should be allocated on the books of the association and revolved when circumstances warrant doing so. In case of losses, the interest of patrons in such reserves should be reduced on as equitable a basis as practicable and the bylaws of the association should give the board of directors authority to order such a reduction.

As previously indicated, a sharp line of demarcation should be drawn between operating and maintenance expense items, and investments which the members of an association make in their association.

The revolving-fund plan of financing is believed to be the most practicable way of insuring that ultimately all the major contributions of patrons to the assets of an association may be returned to them. The fairness of the plan should make it easier for an association to obtain members and to build up adequate capital. It provides a means by which the capital of an association increases as its volume of business increases.

Many of the largest and most successful agricultural cooperatives use this method of financing.<sup>19</sup> It is being adopted not only by new associations but by associations which have been operating for many years.

The validity of the revolving-fund plan of financing has been specifically recognized.<sup>20</sup> Yet it should be kept constantly in mind that a member of a cooperative, like a member of any other business corporation, may be an ordinary creditor thereof. He may make an outright loan to a cooperative and thus become a creditor in the sense in which that term is customarily used. Likewise, a member who supplies money to an association may provide it subject to specific terms and conditions. In the absence of fraud, the courts will ordinarily enforce the terms of such agreements.

To illustrate, in a case <sup>21</sup> involving a cooperative formed by retail grocers to operate a wholesale agency, it appeared that bylaws were adopted pursuant to which 1 percent was added to all statements for the purpose of creating a credit reserve fund "to guarantee the accounts of all members with the Association who receive credit." The bylaws further provided that the amount credited to each member's reserve account "shall be returnable with interest upon the member ceasing to be a member of the Association," less a pro rata percentage of losses sustained by the Association on account of credit extended to members. The funds thus accumulated were not held out as constituting part of the assets of the cooperative. The wholesale agency was placed in bankruptcy and creditors thereof contended that the members had no claims against the bankrupt on account of their contributions to the credit reserve fund, but the Court held otherwise. As agricultural cooperatives that use the revolving-fund plan of financing usually provide that the obligations of the association to the

<sup>19</sup> For example, Washington Cooperative Farmers' Association, Seattle, Washington; Dairymen's League Cooperative Association, Inc., New York, N. Y.; and various associations comprising the Sunkist system in California.

<sup>20</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190; *Adams v. Sanford Growers' Credit Corporation*, 135 Fla. 513, 186 So. 239; *Ozona Citrus Growers' Association v. McLean*, 122 Fla. 188, 165 So. 625; *Proodian v. Plymouth Citrus Growers Association*, 143 Fla. 788, 197 So. 540; *Parker v. Dairymen's League Cooperative Association, Inc.*, 226 N. Y. S. 226, 222 App. Div. 341; *Loomis Fruit Growers' Association v. California Fruit Exchange*, 128 Cal. App. 265, 16 P. 2d 1040. See *Farmers Union Coop. Gin Co. v. Taylor*, 197 Okla. 495, 172 P. 2d 775.

<sup>21</sup> *Warner v. Schoner*, 90 F. 2d 579.

holders of certificates issued in connection therewith are junior and subordinate to the claims of other creditors, the opinion just discussed goes much further than a court ordinarily would be called upon to go in a case involving such a cooperative. The status of certificates which are junior and subordinate to other claims is similar to that of stock certificates.

As showing that borrowed money may be borrowed under such terms and conditions that it may be considered as capital and, therefore, may not be required to be shown on the books of a corporation as a liability, a case<sup>22</sup> in which a cooperative automobile insurance company issued for its preferred stock so-called retirable guaranty-fund certificates so as to enable the company to be exempt from the payment of Federal income taxes, is significant. It was held that the money evidenced by such certificates was borrowed money though the certificates had no fixed maturity dates and their holders "had no right to enforce payment of them" and that the certificates did not have to be carried "as a liability on its books and statements."

Authority for the revolving-fund plan of financing is found in the general rule that a corporation may purchase stock which it has issued. The general rule appears to be that:<sup>23</sup>

A private corporation may purchase its stock if the transaction is fair and in good faith, if it is free from fraud, actual or constructive, if the corporation is not insolvent or in process of dissolution, and if the rights of its creditors are in no way affected thereby.

In view of the fact that a corporation may, under the conditions stated in the foregoing quotations, purchase its capital stock, it appears that there should be no doubt of the right of a cooperative to revolve its capital which is evidenced by stock or other certificates, especially as in the usual situation a cooperative would not actually be depleting its capital because the amount of current contributions to capital would be equivalent to the amount of capital which would be retired, thus leaving the cooperative with substantially the same amount of capital after the transaction had been completed that it had prior thereto. In any event, there would appear to be no basis for applying a stricter rule to the retirement of funds in a revolving fund than is applied in an ordinary case involving the purchase of its own stock by a corporation.

As previously indicated, an association may use stock, revolving-fund certificates, or a certificate bearing a different designation to evidence capital in the revolving fund. In fact, it is not indispensable that any form of certificate be issued to evidence such capital, if the bylaws of the association are clear and specific with reference thereto. In any instance in which it is clear that the obligation of an association to its members on account of money furnished by them for a revolving fund is junior and subordinate to the rights of creditors, it is believed that the right of the association to retire any part of the revolving fund is subject to the rights

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<sup>22</sup> *Commissioner of Internal Revenue v. National Grange Mutual Liability Company*, 80 F. 2d 316. See also *Island Petroleum Company v. Commissioner of Internal Revenue*, 57 F. 2d 992; *Luckenbach v. McCahan Sugar Refining Company*, 248 U. S. 139, 39 S. Ct. 53, 63 L. Ed. 170, 1 A. L. R. 1522; *Stephens v. Simpson*, 87 N. Y. S. 1608, 94 App. Div. 298; *Schachne v. Corporation of Chamber of Commerce*, 102 Misc. Rep. 197, 168 N. Y. S. 791.

<sup>23</sup> *Porter v. Plymouth Gold Mining Company*, 29 Mont. 347, 74 P. 938, 101 Am. St. Rep. 569. See also *Griffin v. Bankers' Realty Investment Company*, 105 Neb. 419, 181 N. W. 169; *Howe Grain & Mercantile Company v. Jones*, 21 Tex. Civ. App. 198, 51 S. W. 24; *Atlanta & Walworth Butter & Cheese Association v. Smith*, 141 Wis. 377, 123 N. W. 106, 32 L. R. A. (N. S.) 137, 135 Am. St. Rep. 42; *Koeppler v. Crocker Chair Company*, 200 Wis. 476, 228 N. W. 130.

of existing creditors. The law is well established that a corporation may not retire any part of its capital stock when to do so adversely affects the rights of current creditors to whom the association is indebted.

In a Minnesota case <sup>24</sup> involving a cooperative, it was said:

To the extent that money, goods or stockholders' notes were exchanged for the stock, the capital of the corporation was depleted. The capital was its own property, but it could not be withdrawn or distributed among stockholders without provision being first made for the full payment of corporate debts.

In another case a corporation issued what were described as participating operation certificates, for which the purchasers paid \$250 and on account of which they were entitled to receive \$500, which was to be paid to the holders of these certificates out of funds obtained by setting aside in a bank 1 cent on each gallon of gasoline and 5 percent on other merchandise sold by each gasoline station concerned. The corporation was placed in the hands of a receiver and the court held that, inasmuch as the participating operation certificates obligated the corporation issuing them to make payments on them only out of receipts from operations, the holders of the certificates were not entitled to claim any part of the funds which had been set aside in a bank (apparently subject to the order of the corporation) with a view to ultimate distribution to the holders of the certificates; but, on the contrary, that the funds should be distributed only among the other creditors of the corporation. <sup>25</sup>

In a case <sup>26</sup> in which a stock corporation issued what were called trade certificates, the corporation issuing them was placed in bankruptcy and the holder of certain of such trade certificates was held on account thereof to be a creditor whose rights were "founded upon an express contract." A certificate entitled its holder to purchase goods of the corporation "at a profit not to exceed 10 percent" and provided that it should be taken into account in the payment of dividends; but the holder was guaranteed the payment of at least 8 percent per annum on the amount of money which he had "deposited" with the corporation. The court said:

The fact that the certificate is payable in merchandise, after the end of two years, on the demand of the holder, in no way detracts from its value as an obligation to pay.

In a Wisconsin case <sup>27</sup> "participating operation certificates" were secured by a deed of trust on real estate. They were payable out of a fund to be created by the deposit in a bank for that purpose of 1 cent for every gallon of gasoline and kerosene sold by the corporation concerned which guaranteed that the certificates would "be paid on or before ten years from the date hereof." The corporation was placed in bankruptcy and its trustees sold the real estate "subject to all legal liens and encumbrances." The purchaser contended that it took title free from the deed of trust securing the certificates. It was urged that the holders of participating operation certificates had the status of "stockholders, profit-sharers, and coadventurers," and not that of creditors, but the court held that as there was a definite promise to pay the certificates on or before 10 years from date, the relation between the corporation and the holders of certificates was

<sup>24</sup> *John H. Lebens, as Receiver of the LeSueur County Cooperative Company v. Nelson*, 148 Minn. 240, 181 N. W. 350, 352. See also *Learmouth v. Caledonia County Cooperative Association*, 109 Vt. 526, 1 A. 2d 732.

<sup>25</sup> *United States & Mexican Oil Co. v. Keystone Auto Gas & Oil Service Co.*, 19 F. 2d 624. See also *Stephenson v. Go-Gas Company*, 268 N. Y. 372, 197 N. E. 317; *In re Hawkeye Oil Company*, 19 F. 2d 151.

<sup>26</sup> *In re Spot Cash Hooper Company*, 188 F. 861, 863.

<sup>27</sup> *Kettenhofen v. Sterling Oil Company*, 226 Wis. 178, 275 N. W. 425.



that of debtor and creditor and that the holders were thus entitled to the security afforded by the deed of trust. On the other hand where participating operation certificates did not have a maturity date and were by their terms payable only out of proceeds arising in the operations of the business, it was held in bankruptcy that the holders of such certificates were "not creditors, but \* \* \* coadventurers \* \* \*," and that the rights of such holders were "subordinate to those of general creditors."<sup>28</sup>

While the writer is of the opinion that the revolving-fund plan of financing may be adopted under the laws of any State, and that such a plan constitutes a valid contractual relationship for which there need be no specific statutory authority, the fact that some States have specifically authorized such a plan<sup>29</sup> is some indication of the increasing recognition given to this cooperative device.

Although a member may have withdrawn from an association, this does not give him a right to receive his interest in a revolving fund, except at the time and in the manner stated in the bylaws.<sup>30</sup>

Whether blue sky laws of a given State are applicable to revolving-fund or other like certificates is a question which should be inquired into in every instance. In a Wisconsin case<sup>31</sup> it was held that the corporation involved was prohibited from offering for sale certain so-called goodwill contracts unless and until a permit had been issued by the Railroad Commission of the State. In this case the court pointed out that the goodwill contracts were neither stock on the one hand nor bonds on the other, but held that this did not prevent them from being a security within the definition of the statute.

Courts have not infrequently been perplexed as to the character of particular forms of certificates which were before them, primarily because of their hybrid character and their ambiguous provisions.<sup>32</sup>

On principle it is believed that certificates issued by cooperatives, irrespective of their designation, should be subordinate to the rights of general creditors for the reason that the members should finance and bear the risks of their own enterprise. The real status of certificates issued by an association should be apparent on their face.

## Associations Operating in Various States

MAY an association formed under the laws of one State do business in other States? At the outset it may be said that generally speaking the power of a corporation to act outside the State of its creation need not be expressly conferred, but may be implied; provided, of course, the State in which a foreign corporation does business consents, and also provided there is no restriction in its charter. The charter of a corporation is the same abroad as it is at home, and wherever it goes for business it carries its charter as the law of its existence. When a State permits a foreign corporation to come within its borders, it is presumed to have consented that the corporation may exercise all the power conferred by its charter and the

<sup>28</sup> *In re Hawkeye Oil Company*, 19 F. 2d 151, 152. See also *McAbee Powder & Oil Company v. Penn-American Gas Coal Company*, 295 F. 630.

<sup>29</sup> Iowa Code Ann., secs. 499.30, 499.33; Utah Code Ann., sec. 3-1-9.

<sup>30</sup> *Reinert v. California Almond Growers Exchange*, 9 Cal. 2d 181, 63 P. 2d 1114, 70 P. 2d 190; *Parker v. Dairymen's League Cooperative Association, Inc.*, 226 N. Y. S. 226, 222 App. Div. 341.

<sup>31</sup> *Brownite Oil Company v. Railroad Commission*, 207 Wis. 88, 240 N. W. 827, 87 A. L. R. 33. See also *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 177 N. W. 937, 938.

<sup>32</sup> 28 Colum. L. Rev. 65.

laws pertaining thereto, unless prohibited from so doing by some direct enactment of the State or some rule of public policy.<sup>33</sup>

If an association desires to enter into marketing contracts with producers in States other than that in which organized, must the association comply with the laws of those States respecting foreign corporations? All the States, it is believed, have statutes relative to foreign corporations doing business within their borders. If a cooperative formed in one State enters into marketing contracts with producers in another State, and the products covered by the contracts on delivery to the association are to be moved out of the State or delivered to the association outside the State in which grown, then it seems clear that an association would not be required to comply with the laws of the State with respect to foreign corporations.<sup>34</sup>

The situation would involve interstate commerce, and the Supreme Court of the United States has held that a corporation of one State may purchase goods in another State for shipment out of the State without the consent of the latter. The following quotation is taken from an opinion of the Supreme Court of the United States.<sup>35</sup>

A corporation of one State may go into another, without obtaining the leave or license of the latter, for all the legitimate purposes of such commerce; and any statute of the latter State which obstructs or lays a burden on the exercise of this privilege is *pro tanto* void under the commerce clause.

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Where goods in one State are transported into another for purposes of sale, the commerce does not end with the transportation, but embraces as well the sale of the goods after they reach their destination and while they are in the original packages. *Brown v. Maryland*, 12 Wheat, 419, 446-447; *American Steel & Wire Co. v. Speed*, 192 U. S. 500, 519. On the same principle, where goods are purchased in one State for transportation to another the commerce includes the purchase quite as much as it does the transportation.

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In no case has the court made any distinction between buying and selling or between buying for transportation to another State and transporting for sale in another State. Quite to the contrary, the import of the decisions has been that if the transportation was incidental to buying or selling it was not material whether it came first or last.

In a Nebraska case<sup>36</sup> it was urged that a cooperative incorporated under the laws of Kansas could not maintain a suit in Nebraska because the association had not complied with the laws of that State respecting foreign corporations, but the Supreme Court of Nebraska held that the association was engaged in interstate commerce and hence was not required to comply with the laws of Nebraska affecting foreign corporations.

A number of the States have provisions in their statutes which specifically refer to cooperatives formed in other States.<sup>37</sup> In 1926, the laws of Indiana<sup>38</sup> provided as follows:

(1) Before any foreign corporation without capital stock and not for pecuniary profit shall be permitted or allowed to transact business or exercise any of its corporate powers in the State of Indiana, it shall be required to file in the office of the

<sup>33</sup> *Milton-Freewater & Hudson Bay Irrigation Co. v. Skeen*, 118 Ore. 487, 247 P. 756, 761.

<sup>34</sup> *Currin v. Wallace*, 306 U. S. 1, 59 S. Ct. 379, 83 L. Ed. 441. But see *Gwin, White & Prince, Inc. v. Henneford*, 193 Wash. 451, 75 P. 2d 1017.

<sup>35</sup> *Dahnke-Walker Milling Co. v. Bondurant*, 257 U. S. 282, 283, 290, 291, 42 S. Ct. 106, 66 L. Ed. 239. See also *Currin v. Wallace*, 360 U. S. 1, 59 S. Ct. 379, 83 L. Ed. 441.

<sup>36</sup> *Nebraska Wheat Growers' Association v. Norquest*, 113 Neb. 731, 204 N. W. 798.

<sup>37</sup> Cooperative Corporation's Law, sec. 76, McKinney's Consolidated Laws of New York, Ann.

<sup>38</sup> Burn's Indiana Statutes, §§ 4925, 4927 (repealed by acts of 1935, c. 157, § 34).

secretary of state a copy of its charter or articles of incorporation, duly certified and authenticated by the officer who issued the original, or the officer with whom the original was filed or recorded. \* \* \*

(3) The secretary of state, upon the admission of such foreign corporation to do business in the State of Indiana, shall issue a certificate and shall state in such certificate of authority to do business issued by him the powers and objects of said corporation which may be exercised in this State, and no corporation shall by this certificate of the secretary by [be] authorized to transact any business in this State for the transaction of which a corporation can not be organized under the laws of Indiana.

The Dark Tobacco Growers' Cooperative Association, incorporated under the Cooperative Act of Kentucky, applied for and received a license to do business in Indiana. It successfully brought suit on the contract it had entered into with a producer in Indiana.<sup>39</sup> One of the defenses interposed was that an association similar to the Dark Tobacco Growers' Cooperative Association could not have been organized in the State of Indiana and hence that the license to do business in the State that had been issued to the association was void. It will be observed that the statutory provisions quoted above authorize the granting of licenses to do business in the State to associations of a type that could have been formed in the State of Indiana.

In the case under discussion it was claimed that the association was engaged in interstate commerce, but the court pointed out that the application for a license appeared to be an admission that the association was not engaged in such commerce. The court further pointed out that there was no allegation in the complaint of the association that the contract sued on was a part of an interstate commerce transaction. The court, however, said: "If the contract entered into had been a part of a transaction connected with interstate commerce, such license would not have been necessary."

If a California corporation ships a carload of fruit to a commission merchant in New York to be sold by him on agreed factorage, is the California corporation doing business in New York within the meaning of its statutes of this character? If it contracts to ship 1,000 carloads during the year on the same terms, is it violating the statutes of New York, unless it obtains a license to do business there? <sup>40</sup>

The answer to the foregoing questions is "No." In addition, a number of the State courts, independent of interstate commerce, have held that their laws respecting foreign corporations do not apply when the corporations only ship goods into their States to be sold by factors or commission men. The answers just given will be amplified later.

The general statute of each State regarding the right of a corporation formed in another State to do business within its borders is as applicable to incorporated cooperatives as to other corporations, unless the language of a particular statute is not broad enough to cover them, the associations are engaged in interstate commerce, or for some other reason such statutes are not by their terms applicable to them.

Generally, application to do business in a State (other than the one of incorporation) must be made to the secretary of state of that State. Usually before permission to do business in the new State can be obtained, it must appear that a corporation could be formed in that State to engage in the business in which the applicant is engaged. Other usual requirements are a known place of business and a designated person upon whom process may be served.

<sup>39</sup> *Dark Tobacco Growers' Coop. Association v. Robertson*, 84 Ind. App. 51, 150 N. E. 106, 110.

<sup>40</sup> *Butler Bros. Shoe Co. v. United States Rubber Co.*, 156 F. 1, 6.



A State has the right to exclude the corporations of other States<sup>41</sup> except that a State may not exclude or impose conditions on a corporation that is engaged in interstate or foreign commerce.<sup>42</sup> As a part of interstate commerce, a corporation of one State has the right to ship goods into another State and there sell them in the original packages without the leave or license of that State. Again, a corporation of one State may purchase goods in one State for shipment to another without the consent of the latter State.<sup>43</sup> A single isolated act or transaction does not constitute doing business in a State.<sup>44</sup>

It is immaterial how a cooperative markets its products in another State provided they are sold in the original packages or are shipped into the State in response to orders previously obtained for them.<sup>45</sup>

In a leading case decided by the United States Supreme Court<sup>46</sup> it appeared that the State of Michigan imposed an annual tax of \$300 upon the business of selling brewed or malt liquors. Citizens of Wisconsin, engaged in manufacturing such liquors in that State, owned a warehouse in Michigan to which they shipped and in which they stored their liquor for sale in the original packages. Neither they nor their agent paid the tax, but the agent sold the liquor and was arrested and convicted for a violation of the law. The Supreme Court, in holding that the State of Michigan did not have the right to impose the tax, either on the citizens of Wisconsin or upon their agent in Michigan, said:

We have repeatedly held that no State has the right to lay a tax on interstate commerce in any form, whether by way of duties laid on the transportation of the subjects of that commerce, or on the receipts derived from that transportation, or on the occupation or business of carrying it on, for the reason that such taxation is a burden on that commerce, and amounts to a regulation of it, which belongs solely to Congress.

In another case,<sup>47</sup> the Supreme Court of the United States said:

We have repeatedly decided that a State law is unconstitutional and void which requires a party to take out a license for carrying on interstate commerce, \* \* \*.

It will be appreciated that the term "original packages" refers to the barrels, boxes, or other containers in which substantial quantities of the product involved are transported.

Entirely independent, apparently, of the fact that interstate commerce was involved, a number of the supreme courts have held that a foreign corporation was not doing business in the State when it appeared that the foreign corporation consigned products to a commission merchant or factor in the State to be sold.<sup>48</sup> These cases apparently were decided upon the

<sup>41</sup> *Pembina Consolidated Silver Mining & Milling Co. v. Pennsylvania*, 125 U. S. 181, 8 S. Ct. 737, 31 L. Ed. 650.

<sup>42</sup> *Dahnke-Walker Milling Co. v. Bondurant*, 257 U. S. 282, 42 S. Ct. 106, 66 L. Ed. 239.

<sup>43</sup> *Ibid.*, n. 42.

<sup>44</sup> *Cooper Manufacturing Co. v. Ferguson*, 113 U. S. 727, 5 S. Ct. 739, 28 L. Ed. 1137.

<sup>45</sup> *Caldwell v. North Carolina*, 187 U. S. 622, 23 S. Ct. 229, 47 L. Ed. 336.

<sup>46</sup> *Lyng v. Michigan*, 135 U. S. 161, 166, 10 S. Ct. 725, 34 L. Ed. 150.

<sup>47</sup> *Crutcher v. Kentucky*, 141 U. S. 47, 58, 11 S. Ct. 851, 35 L. Ed. 649.

<sup>48</sup> *Allen v. Tyson-Jones Buggy Co.*, 91 Tex. 22, 40 S. W. 393; *In re Hovey's Estate*, 9 Pa. Dist. Rep. 183, affirmed in 198 Pa. 385, 48 A. 311; *Cooper Rubber Co. v. Johnson*, 133 Tenn. 562, 182 S. W. 593; *Bertha Zinc & Mineral Co. v. Clute*, 27 N. Y. S. 342, 7 Misc. Rep. 123, 57 N. Y. St. Rep. 70; *Badische Lederwerke v. Capitelli*, 155 N. Y. S. 651, 92 Misc. Rep. 260. See also *Patent Royalties Corporation v. Land O'Lakes Creameries, Inc.*, 11 F. Supp. 103; *Universal Oil Corporation v. Falls Rubber Co.*, 188 Okla. 401, 110 P. 2d 296.

theory that it was the factor or commission man that was engaged in business in that State and not the foreign corporation.

It is submitted that a cooperative formed in one State, and marketing its products in another, cannot be required to comply with the laws of the latter State respecting foreign corporations if it sells its products in the original packages in which they are shipped into the State through a commission man, factor, or broker, or through the medium of its own exclusive agent located in that State. Nor may the latter State impose a tax for doing business, either on the cooperative or upon its agent, on account of such business.

Generally, a State has the right to oust a corporation for violating its laws. The Burley Tobacco Growers' Cooperative Association, incorporated under the laws of Kentucky, complied with the laws of Tennessee relative to foreign corporations and began to do business in that State. Later the State of Tennessee instituted ouster proceedings against it on the ground that the association had been guilty of coercion in obtaining contracts and was seeking to restrain trade unreasonably. It was held, however, that the association was not guilty of the things charged and that it was entitled to do business in Tennessee.<sup>49</sup>

A distinction should be drawn between the right of a State to tax physical property within its borders as contrasted with the right of an individual or corporation to engage in interstate commerce within the State. Physical property, such as commodities,<sup>50</sup> trucks, buildings, or equipment, owned by a cooperative in a State other than that in which it is organized, or similar property owned by the agent of the association in that State, is subject to the normal and customary property taxes free from discrimination within that State.<sup>51</sup>

If a cooperative or other corporation is doing an intrastate business in a State other than that in which it is organized, it is a serious matter for it to fail to comply with the laws of that State regarding foreign corporations. In many States an association could not sue in the courts of the State, nor could it enforce its obligations in the Federal courts if it had failed to comply with such laws.<sup>52</sup> In Tennessee, the shareholders of a foreign corporation, under the circumstances in question, were held liable as partners.<sup>53</sup> In Colorado and some other States the officers and agents of such a corporation are by statute made personally liable.<sup>54</sup>

When a cooperative formed in one State is operating in another, the existence and extent of the right of its members to control the actions of its officers or agents and the relation of the members to the association are determined by the law of the State in which it was incorporated, even though this question arises in the latter State.<sup>55</sup>

As a general rule, the courts of one State will not take jurisdiction of the internal affairs of a corporation incorporated in a different State.<sup>56</sup>

<sup>49</sup> *Tennessee v. Burley Tobacco Growers' Coop. Association*, 2 Tenn. App. Rep. 674.

<sup>50</sup> *Sonneborn Bros. v. Cureton*, 262 U. S. 506, 43 S. Ct. 643, 67 L. Ed. 1095.

<sup>51</sup> *Southern Ry. Co. v. Kentucky*, 274 U. S. 76, 47 S. Ct. 542, 71 L. Ed. 934.

<sup>52</sup> *Woods v. Interstate Realty Co.*, 337 U. S. 535, 69 S. Ct. 1235, 93 L. Ed. 1524.

<sup>53</sup> *Cunningham v. Shelby*, 136 Tenn. 176, 188 S. W. 1147, L. R. A. 1917B 572.

<sup>54</sup> *Fritts v. Palmer*, 132 U. S. 282, 10 S. Ct. 93, 33 L. Ed. 317; 51 A. L. R. 376, 389.

<sup>55</sup> *Farmers Educational and Cooperative Union of America, Minnesota Division v. Farmers Educational and Cooperative Union of America*, 207 Minn. 80, 289 N. W. 884; *Schwabe v. American Rural Credits Association*, 104 Neb. 46, 175 N. W. 673.

<sup>56</sup> *Farmers Educational and Cooperative Union of America, Minnesota Division v. Farmers Educational and Cooperative Union of America*, 207 Minn. 80, 289 N. W. 884.

The Supreme Court of the United States has said:

In order to hold a foreign corporation not licensed to do business in a state responsible under the process of a local court the record must disclose that it was carrying on business there at the time of attempted service.<sup>57</sup>

If an association is doing business in a State, it may be sued therein.<sup>58</sup>

## Associations and Third Persons

IF PRODUCTS in the custody of an association are damaged, for instance, by fire caused by the negligence of a third person, an association may bring suit for the recovery of the damages in question.<sup>59</sup> Again, if a person has entered into a contract with an association to buy a specified quantity of products, the association may sue for failure to comply with the contract.<sup>60</sup> Conversely, if a cooperative enters into a contract to sell a specified quantity of products, ordinarily it may be sued successfully for failure to abide by the contract.<sup>61</sup> Cooperatives like other concerns may be compelled through the remedy of specific performance to perform contracts which they have made; and in a certain case a cooperative was given the alternative of delivering its preferred stock in payment for warehouses or of responding in damages.<sup>62</sup> It should be remembered that if an association makes an unconditional contract to sell a specified quantity of products, the contract is binding, and damages may be recovered for its breach unless its performance was prevented by law, an act of God such as floods, or the other party. An association should include exceptions in its selling contracts covering contingencies such as strikes which may prevent the association from performing its contracts.

Cooperatives like other business concerns, should exercise care to have the contracts they enter into with third persons clear and definite. That ambiguous contracts may lead to legal difficulties is well illustrated by a Washington case in which the facts were somewhat equivocal.<sup>63</sup> In this case a cooperative successfully contended that the defendant had purchased a carload of strawberries from it and was not acting simply as a broker in the sale of the strawberries. It was held also that a check which was received and cashed by the association from the defendant did not amount to an accord and satisfaction of the obligation because it was not submitted as "payment in full, nor was the remittance accompanied by any act or declaration which would amount to a condition that the money tendered, if accepted, would be accepted as a satisfaction in full."

<sup>57</sup> *International Harvester Co. v. Kentucky*, 234 U. S. 579, 34 S. Ct. 944, 58 L. Ed. 1479. See also *Farmers' Union Livestock Commission, Inc. v. District Court of Seventh Judicial District*, 93 Utah 181, 72 P. 2d 448.

<sup>58</sup> *Patent Royalties Corp. v. Land O' Lakes Creameries, Inc.*, 11 F. Supp. 103; *Eastern Livestock Cooperative Marketing Association v. Dickenson*, 107 F. 2d 116.

<sup>59</sup> *Louisville & Nashville Railroad Co. v. Burley Tobacco Society*, 147 Ky. 22, 143 S. W. 1040.

<sup>60</sup> *National Importing Co. v. California Prune and Apricot Growers, Inc.*, 85 Ind. App. 315, 151 N. E. 626; *Tustin Fruit Association v. Earl Fruit Company*, 6 Cal. Unrep. 37, 53 P. 693; *Consumers Cooperative Association v. Sherman*, 147 Neb. 901, 25 N. W. 2d 548.

<sup>61</sup> *Eskew v. California Fruit Exchange*, 203 Cal. 257, 263 P. 804.

<sup>62</sup> *Tri-State Terminal Company v. Washington Wheat Growers' Association*, 134 Wash. 519, 236 P. 75.

<sup>63</sup> *Three Rivers Growers' Association v. Pacific Fruit and Produce Company*, 159 Wash. 572, 294 P. 233, 235. See also on the question whether a check is satisfaction of an indebtedness, *Staples v. Growers' Finance Corporation*, 44 Ga. App. 451, 161 S. E. 675; *Work v. Associated Almond Growers of Paso Robles*, 102 Cal. App. 232, 282 P. 965; *Blue Ribbon Creamery v. Monk*, 168 Miss. 130, 147 So. 329, 782.



In another case a seller of livestock unsuccessfully contended that an association had bought his livestock and had not acted as agent for their sale.<sup>64</sup>

Generally speaking, if an agent exceeds his authority his principal is not bound. An association entered into a sales-agency contract with a distributor, covering the disposition of onions received by the association from its members. The distributor then entered into a contract with another party, purporting to authorize this party to make sales of onions. The association was not bound by this contract, as the distributor exceeded his authority as specified in the sales-agency contract, and the association, on learning of this fact, refused to acquiesce therein.<sup>65</sup>

If a cooperative is purchasing a business, including its goodwill, a stipulation should be included in the contract of purchase precluding the seller from engaging in the same business in the same town if the association desires to prevent the seller from doing so,<sup>66</sup> otherwise, the general rule is that the seller is not barred from again engaging in business in the same town.<sup>67</sup>

In a number of cases contracts entered into by milk bargaining cooperatives with milk distributors for the purpose of bringing about a market pool so that all producers similarly situated will be paid the same price for their milk have been held valid.<sup>68</sup>

As a person's acts usually speak louder than his words, where a representative of an association took possession of warehouses covered by a contract, declarations made by the representative that the possession taken was only a qualified one did not have the effect of modifying the original contract.<sup>69</sup>

Whether money left with a bank results in the relation of bailor and bailee, or in that of debtor and creditor, depends upon the terms and conditions under which the money was left with the bank.<sup>70</sup> In the first instance the association would be entitled to priority in the event of insolvency of the bank, while in the second case it would not; and an agreement for the bank to pay interest indicates a debtor-creditor relationship.<sup>71</sup>

While it has been held that a milk association may be enjoined from

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<sup>64</sup> *Eastern Livestock Cooperative Marketing Association v. Dickenson*, 107 F. 2d 116.

<sup>65</sup> *Eck Company v. Coachella Valley Onion Growers' Association*, 102 Cal. App. 1, 282 P. 408.

<sup>66</sup> *Dairymen's League Coop. Association, Inc. v. Weckerle*, 160 Misc. 866, 291 N. Y. S. 704.

<sup>67</sup> *Farmers' Cooperative Elevator of Fowler v. Sturgis & Sons*, 226 Mich. 437, 198 N. W. 191.

<sup>68</sup> *Stark County Milk Producers' Association v. Tabeling*, 129 Ohio St. 159, 194 N. E. 16, 98 A. L. R. 1393; *Dairy Cooperative Association v. Brandes Creamery*, 147 Ore. 488, 30 P. 2d 338, 147 Ore. 503, 30 P. 2d 344; *United States v. Rock Royal Cooperative, Inc.*, 307 U. S. 533, 59 S. Ct. 993, 83 L. Ed. 1446; *Hood & Sons, Inc. v. United States*, 307 U. S. 588, 59 S. Ct. 1019, 83 L. Ed. 1478; *Connecticut Milk Producers' Association v. Brock-Hall Dairy Co., Inc.*, 122 Conn. 482, 191 A. 326.

<sup>69</sup> *Tri-State Terminal Company v. Washington Wheat Growers' Association*, 134 Wash. 519, 236 P. 75.

<sup>70</sup> *Bank of Aurora v. Aurora Coop. Fruit Growing & Marketing Association*, 91 S. W. 2d 177 (Mo. App.); *Oak Grove Farmers' Mutual Ins. Co. v. Almenna State Bank of Almenna*, 216 Wis. 182, 256 N. W. 696; *California Livestock Commission Co. v. Button*, 40 Ariz. 65, 9 P. 2d 414; *Florida Citrus Exchange v. Union Trust Co. of Rochester*, 244 App. Div. 68, 278 N. Y. S. 313.

<sup>71</sup> *Lewis v. Dark Tobacco Growers' Cooperative Association*, 247 Ky. 301, 57 S. W. 2d 8.

injuring a milk distributor in the operation of his business,<sup>72</sup> in another case the court held that a milk distributor had no cause of action against a milk association for diverting milk from the milk distributor, unless the milk distributor could show that but for the acts of the association he would have obtained a sufficient supply of milk to meet his needs.<sup>73</sup>

Where a member of an association assigned his claim against it on account of commodities delivered by him under his marketing contract, the member no longer had an interest in the claim which was subject to attachment.<sup>74</sup> A cooperative as a debtor can assert against an assignee of the debt a counterclaim based on the obligation of his assignor maturing subsequent to the assignment but before notice thereof to the association.<sup>75</sup>

An association which is not a member of another cooperative may by contract become liable for obligations incurred by the other cooperative.<sup>76</sup>

As illustrating the flexibility of the law of contracts a Minnesota case<sup>77</sup> is of interest. In this case certain persons sold a stock of merchandise to a cooperative and agreed to look for payment only to the proceeds derived from sale of such stock, which was to be sold "as rapidly as possible." The contract of sale was held valid.

Inasmuch as the jury found that a chick association had agreed to bear all losses which might arise from the purchase of chicks in case they developed a disease, the purchaser had the right to recover not only the purchase price of the chicks after their return, but also all other losses arising from their purchase.<sup>78</sup>

## Hedging

Inasmuch as hedging is so widely practiced by cooperatives which handle agricultural commodities that are dealt in on future markets or exchanges, a brief explanation of hedging appears in order. Hedging is regarded as a type of insurance.<sup>79</sup> When an association or a producer<sup>80</sup> of grain, for instance, desires to effect a hedge with respect to spot grain, or with respect to grain which is being produced, a sale is made of substantially a corresponding amount on a grain futures market or exchange. The spot grain, or the grain that is being produced, might be used for the making of delivery of the grain sold in the futures market, but this is seldom done. Ordinarily, on the sale of the actual grain the seller buys an amount of grain in the futures market equal to that previously sold in that market and thus the transaction in futures is closed. Normally, it is expected that if the price of grain declines the "profits" made on the grain sold in the futures market will approximate the "loss" taken on the actual grain, so that the transaction in theory results in the seller obtaining a net price for his actual grain approximating the price at which the grain was sold in the

<sup>72</sup> *Pure Milk Producers' Association of Greater Kansas City Territory v. Bridges*, 146 Kan. 15, 68 P. 2d 658.

<sup>73</sup> *Hy-Grade Dairies v. Falls City Milk Producers' Association*, 261 Ky. 25, 86 S. W. 2d 1046.

<sup>74</sup> *Stivers v. Steele (Burley Tobacco Growers Association)*, 230 Ky. 700, 20 S. W. 2d 717.

<sup>75</sup> *Maryland Cooperative Milk Producers v. Bell*, 206 Md. 168, 110 A. 2d 661.

<sup>76</sup> *New York Canning Crops Coop. Association, Inc. v. Slocum*, 126 Misc. Rep. 30, 212 N. Y. S. 534.

<sup>77</sup> *In re Blue Earth County Cooperative Company*, 139 Minn. 231, 166 N. W. 178.

<sup>78</sup> *Letres v. Washington Cooperative Chick Association*, 8 Wash. 2d 64, 111 P. 2d 594.

<sup>79</sup> *Fraser v. Farmers' Cooperative Company*, 167 Minn. 369, 209 N. W. 33, reargument denied 167 Minn. 369, 209 N. W. 913; *Benson-Stabeck Company v. Reservation Farmers' Grain Co.*, 62 Mont. 254, 205 P. 651.

<sup>80</sup> *Edgeley Cooperative Grain Company v. Spitzer*, 48 N. D. 406, 184 N. W. 880, 20 A. L. R. 1417.

futures market. When a handler of grain has contracted to deliver actual grain at a given time which he expects to acquire in the meantime, he may purchase a like amount of grain on a futures market and then on the purchase of the actual grain by him he sells the grain which he purchased in the futures market. In general, hedging contracts are valid.<sup>81</sup>

## Unincorporated Associations

**I**NASMUCH as some cooperatives are unincorporated, a discussion of the legal status of such associations and the rights and liabilities of their members is in order. An unincorporated association may be defined as a body of persons acting together without a charter, but employing to a greater or less extent the forms and methods used by incorporated bodies for the prosecution of the purposes for which the body is formed.<sup>82</sup>

### Characteristics

The liability of members of an unincorporated business association to third persons is the same as that of partners. In a Vermont case<sup>83</sup> it was said: "Here a voluntary association, composed of many members, adopting bylaws, having an associate name, and providing for certain officers and prescribing their duty, was but a partnership in the eyes of the law." In the absence of a statutory or contractual provision on the subject, the death or withdrawal of a member does not dissolve the association.<sup>84</sup> A partnership, on the contrary, under such circumstances is dissolved by the death or withdrawal of a member.<sup>85</sup>

Again, a corporation may sue or be sued in its own name, while at common law, and in the absence of a statute, an unincorporated association cannot maintain an action in its own name but must sue in the names of all the members composing it, however numerous they may be.<sup>86</sup> Likewise, such an association in the absence of a statute cannot be sued in its society name but the individual members must be sued.<sup>87</sup> A corporation may take title to property in its own name, but an unincorporated association, in the absence of a statute, is ordinarily incapable as an organization of taking or holding either real or personal property in its name.<sup>88</sup>

<sup>81</sup> Annotation "Nature and validity of 'hedging' transactions on the commodity market," 20 A. L. R. 1422. See also *Makeever v. Barker*, 85 Ind. App. 418, 154 N. E. 692; *Clark v. Murphy*, 142 Kan. 426, 49 P. 2d 973; *South Carolina Cotton Growers' Coop. Association v. Weil*, 220 Ala. 568, 126 So. 637; *Fagerberg v. Phoenix Flour Mills Co.*, 50 Ariz. 227, 71 P. 2d 1022.

<sup>82</sup> 7 C. J. S. Associations, sec. 1.

<sup>83</sup> *Houghton v. Grimes*, 100 Vt. 99, 135 A. 15, 18.

<sup>84</sup> *Burke v. Roper*, 79 Ala. 138; *Lindemann & Hoverson Co. v. Advance Stove Works*, 170 Ill. App. 423; *Hossack v. Ottawa Dev. Association*, 244 Ill. 274, 91 N. E. 439.

<sup>85</sup> *Scholefield and Taylor v. Eichelberger*, 7 Pet. 586, 32 U. S. 586, 8 L. Ed. 793.  
<sup>86</sup> *St. Paul Typothetae v. St. Paul Bookbinders' Union No. 37*, 94 Minn. 351, 102 N. W. 725; *Newton County Farmers' & Fruit Growers Exchange v. Kansas City Southern Railway Co.*, 326 Mo. 617, 31 S. W. 2d 803; *Old River Farms Company v. Roscoe Haegelin Company*, 98 Cal. App. 331, 276 P. 1047. If an unincorporated association fails to comply with statutory requirements for bringing suit under the association name, it lacks capacity to sue in this form. *Kadota Fig Association of Producers v. Case-Swayne Co.*, 73 Cal. App. 2d 815, 167 P. 2d 518. Nor can it file a cross complaint in an action filed against it. *Case v. Kadota Fig Association of Producers*, 207 P. 2d 86 (Cal. D. C. of App.).

<sup>87</sup> *Allis-Chalmers Co. v. Iron Molders' Union No. 125*, 150 F. 155; *Board of Railroad Commissioners v. Reed*, 102 Mont. 382, 58 P. 2d 271.

<sup>88</sup> *Philadelphia Baptist Association v. Hart's Executors*, 4 Wheat. 1, 4 L. Ed. 499; *Idaho Apple Growers Association v. Brown*, 50 Idaho 34, 293 P. 320, 51 Idaho 540, 7 P. 2d 591.



## How Formed

Statutes have been passed in some States expressly authorizing individuals to unite as a voluntary association under a distinctive name, but as a rule, the organization of unincorporated or voluntary associations is done independent of statutes. They are generally formed under the common law right of contract. Just as A and B may enter into a contract with reference to doing some lawful act, so a larger number may associate for the accomplishment of a lawful objective.

Provision may be made for any matter that is a legitimate subject of contract. The qualifications of members may be prescribed, and causes for expulsion may be specified. A constitution is usually adopted which states the purposes of the association and other fundamental propositions relative to the organization. Bylaws are also usually adopted which prescribe the manner in which the objectives of the association are to be attained. The constitution and the bylaws, or either of them, constitute a contract binding all those who agree to them.

In a Michigan case<sup>89</sup> it was said: "The articles of agreement of such an association, whether called a 'constitution,' 'charter,' 'bylaws,' or any other name, constitute a contract between the members which the courts will enforce if not immoral, or contrary to public policy or the law of the land." The foregoing was quoted approvingly in a Kansas case<sup>90</sup> involving an antihorse-thief association, and it is believed it states the general rule.<sup>91</sup> It follows that, inasmuch as a voluntary association rests on a contract or contracts, the rights or liabilities of members among themselves are to be determined by the contracts involved in accordance with common law principles as modified or supplemented by statutes; and in the absence of a constitution or bylaws, the courts will apply the same legal rules for ascertaining the rights of the parties, weight being given to any usages or customs which may have been followed by the association.<sup>92</sup>

It should be remembered that in order for a constitution and bylaws, or either of them, to constitute a contract between an association and one claiming or alleged to be a member, he must have agreed to them, either by signing papers containing the constitution and bylaws, or by assenting to them in some other way.<sup>93</sup> If one, in joining an association, signs its constitution and bylaws or assents to them in some other way and thus agrees to be bound by them, he is in no position to complain because he is required to comply with the rules and regulations of the association to which he agreed or because he is expelled from the association in accordance with them.<sup>94</sup>

In a New York case<sup>95</sup> involving the New York Stock Exchange, in which it appeared that a former member had been expelled for cause, the court of appeals of that State said:

The interest of each member in the property of the association is equal, but it is subject to the constitution and bylaws, which are the basis on which is founded the association. They express the contract by which each member has consented to be bound, and which measures his duties, rights, and privileges as such. It seems most clear to me that this constitution and the bylaws derive a binding force from the fact that they are signed by all the members, and that they are conclusive upon each

<sup>89</sup> *Brown v. Stoerkel*, 74 Mich. 269, 41 N. W. 921, 923, 3 L. R. A. 430.

<sup>90</sup> *McLaughlin v. Wall*, 86 Kan. 45, 119 P. 541.

<sup>91</sup> *Kalbitzer v. Goodhue*, 52 W. Va. 435, 44 S. E. 264.

<sup>92</sup> *Ostrom v. Greene*, 161 N. Y. 353, 55 N. E. 919.

<sup>93</sup> *Austin v. Searing*, 16 N. Y. 112, 69 Am. Dec. 665, and note.

<sup>94</sup> *State ex rel. Rowland v. Seattle Baseball Association*, 61 Wash. 79, 111 P. 1055.

<sup>95</sup> *Belton v. Hatch*, 109 N. Y. 593, 17 N. E. 225, 226, 4 Am. St. Rep. 495.

of them in respect to the regulations of the mode of transaction of his business, and of his right to continue to be a member.

In another case<sup>96</sup> it was said:

The San Francisco Stock and Exchange Board is a voluntary association. The members had a right to associate themselves upon such terms as they saw fit to prescribe, so long as there was nothing immoral or contrary to public policy or in contravention of the law of the land in the terms and conditions adopted. No man was under any obligation to become a member unless he saw fit to do so, and when he did and subscribed to the constitution and bylaws, thereby accepting and assenting to the conditions prescribed, he acquired just such rights, with such limitations and no others, as the articles of association provided for.

## **Admission of Members in Unincorporated Associations**

It has been previously stated that an unincorporated association may prescribe the qualifications of members. It cannot be compelled to admit as members persons whom it chooses to exclude.<sup>97</sup>

In other words, the whole matter of the admission of members rests with the association. This is well illustrated in the case of farmers' telephone lines. The question of whether membership can be sold with the farm in such instances has arisen. It is held that an association has the right to control its membership, and a purchaser of a farm merely by virtue of his warranty deed does not become a member of such telephone company.<sup>98</sup>

## **Membership Nontransferable**

Membership in an unincorporated association is not transferable unless the constitution or bylaws provide that it shall be.<sup>99</sup> The interest of a member in such an association is not devisable or transmissible, and his estate receives nothing therefrom on his death<sup>1</sup> in the absence of a contractual or statutory provision to the contrary.

## **Control of an Unincorporated Association**

In the absence of an agreement to the contrary, within the scope of the objects for which an association was formed, whether such objects are mentioned in the constitution or other paper defining the objects of the association or are necessarily implied therefrom, a majority of the members possess authority to control the action of the association.<sup>2</sup> The majority controls, however, only while the cooperative is doing those things for which it was organized. If it is desired to have the association do something different from that for which it was formed, unanimous consent is necessary.<sup>3</sup>

## **Notice of Meetings**

If the constitution or bylaws provide how members shall be notified of meetings, they must be followed.<sup>4</sup> In general, all members are entitled

<sup>96</sup> *Hyde v. Woods*, 94 U. S. 523, 24 L. Ed. 264.

<sup>97</sup> *Richardson v. Union Congregational Society of Francetown*, 58 N. H. 187.

<sup>98</sup> *Cantril Telephone Co. v. Fisher*, 157 Iowa 203, 138 N. W. 436, 42 L. R. A. (N. S.) 1021.

<sup>99</sup> *Moore v. Hillsdale County Telephone Co.*, 171 Mich. 388, 137 N. W. 241; *McMahon v. Rauhr*, 47 N. Y. 67.

<sup>1</sup> *Sommers v. Reynolds*, 103 Mich. 307, 61 N. W. 501; *Mason v. Atlanta Fire Co.*, 70 Ga. 604, 48 Am. Rep. 585.

<sup>2</sup> 4 Cyc. 310; *Goller v. Stubenhaus*, 134 N. Y. S. 1043, 77 Misc. 29; *Ace Bus Transportation Company v. South Hudson County Boulevard Bus Owners' Association*, 118 N. J. Eq. 31, 177 A. 360, affirmed in 119 N. J. Eq. 37, 180 A. 835.

<sup>3</sup> *Abels v. McKeen*, 18 N. J. Eq. 462.

<sup>4</sup> *Kuhl v. Meyer*, 42 Mo. App. 474.

to notice of all meetings and of the matters to be considered at such meetings. If matters of an unusual character are to be considered at a meeting, it is particularly important that the nature of the business be brought to the attention of each member.<sup>5</sup>

### Unincorporated Associations and Third Persons

The liability of the members of an association that is not engaged in business has been said to rest upon the principles of agency.<sup>6</sup> An illustration will make this more clear. In a Massachusetts case<sup>7</sup> the constitution stated that the association was formed to stimulate interest in the breeding of pigeons and bantams. It gave the board of directors charge of all public exhibitions of the society and required each member to pay an initiation fee and an annual assessment. An exhibition was held, and premiums were offered. The expenses thereof were greater than the receipts. Certain of the members paid the bills. They then brought suit against other members of the association to compel them to contribute their respective proportions of the loss sustained. The court said:

Mere membership would not bind anybody for any further payment than the initiation fee and annual assessment; but such members as participated in a vote to incur further expenses for an exhibition with premiums, or as assented to be bound by such vote, would be bound thereby.

In other words, only those members were liable who authorized the exhibition with premiums or who later ratified the act of holding such an exhibition. The other members were not liable.

In a Michigan case<sup>8</sup> the members of a building committee of an unincorporated religious society ordered lumber of a dealer for the building of a church. A dispute arose, and the dealer brought suit against the members of the building committee, and won. In holding the defendants liable, the court said:

The church organization had no legal existence. It could neither sue nor be sued. The members of the society were not partners. Those of the society who were actually instrumental in incurring the liabilities for it are liable as either principals or agents having no legal principal behind them. Members of the society who either authorized or ratified the transactions are liable, while those who did not are exempt from liability.

All the authorities apparently agree that, if a particular debt or obligation was necessarily incurred for the express purpose for which the association was formed, each member thereof is liable. In a South Dakota case<sup>9</sup> the following language was used with reference to this situation:

\* \* \* each member of an unincorporated or voluntary association is liable for the debts thereof incurred during his period of membership, and which had been necessarily contracted for the purpose of carrying out the objects for which the association was formed.

In another case those in charge of an association were expected to make advances on the delivery of commodities, and to make other disbursements. The association had no capital. It was held that those in charge of the

<sup>5</sup> *State ex rel Rowland v. Seattle Baseball Association*, 61 Wash. 79, 111 P. 1055.

<sup>6</sup> 7 C. J. S. Associations, sec. 32.

<sup>7</sup> *Ray v. Powers*, 134 Mass. 22.

<sup>8</sup> *Clark v. O'Rourke*, 111 Mich. 108, 69 N. W. 147, 148, 66 Am. St. Rep. 389.

<sup>9</sup> *Lynn v. Commercial Club of Witten*, 31 S. D. 401, 141 N. W. 471. See also *Little Rock Furniture Mfg. Co. v. Kavanaugh*, 111 Ark. 575, 164 S. W. 289, 51 L. R. A. (N. S.) 406, Ann. Cas. 1916A 848; *Schumacher v. Sumner Tel. Co.*, 161 Iowa 326, 142 N. W. 1034, Ann. Cas. 1916A 201; *Dinsmore v. J. H. Calvin Co.*, 214 Ala. 666, 108 So. 583.



association had implied authority to borrow money, with resulting liability to the members.<sup>10</sup>

The question sometimes arises as to the liability of officers of an unincorporated association for debts contracted by them for the association. In the case of a business association the officers ordinarily are personally liable for its debts, but if they include a provision in the contract creating the obligation that they are not personally liable, then they are free from personal responsibility for the debt. The secretary of the North Dakota Farm Bureau Federation, an unincorporated organization, brought suit against the federation and its officers to recover for services rendered by him for the federation. It was held that, as the officers of the federation stipulated that they were not to be bound individually, they were not individually liable upon the contract made with the secretary.<sup>11</sup>

In an Arkansas case<sup>12</sup> it appeared that growers of sweetpotatoes took steps to form an incorporated cooperative for the purpose of curing and preserving potatoes. No corporation was formed, but persons selected as officers of the association by those interested in forming it executed two promissory notes in the name of the Ashdown Potato Curing Association, signing their own names as president and secretary, respectively. The money was used for building a potato-curing house. The venture failed. In connection with the project, subscription lists for stock were circulated. A suit was brought on the notes against the two officers of the association and about 60 other persons who were alleged to have been interested. The question for decision was who were liable on the notes. The Supreme Court of Arkansas in passing on this question said:

\* \* \* it was a voluntary, unincorporated association, in effect a partnership, and \* \* \* the only question in the case was the identity of the persons who composed the association at the time the notes in suit were executed.

This case illustrates how those interested in the formation of an incorporated association may, if the plans for incorporation fail, be held liable as members of an unincorporated association.

If an unincorporated association is engaged in business the members are liable as partners to third persons. This obligation is imposed by law on the members of such an association, and it is immaterial what the rules of the association provide on the subject of liability.<sup>13</sup> In a California case,<sup>14</sup> suit was brought by the plaintiff against an unincorporated cooperative, and certain of its members, to recover the sale price of goods purchased by the association for use in its business. The association was composed of 19 members. The plaintiff obtained a judgment against two of the members of the association, and they appealed on the ground that they could not be held individually responsible. In affirming the judgment of the lower court, the Court of Appeals of California said that the case came within the rule announced in volume 5, *Corpus Juris*, 1362, 1373, as follows:

While as between the members of an unincorporated association, each is bound to pay only his numerical proportion of the indebtedness of the concern, yet as against the creditors, each member is individually liable for the entire debt, provided,

<sup>10</sup> *Tomlin v. Petty*, 244 Ky. 542, 51 S. W. 2d 663.

<sup>11</sup> *Fuller v. Reed*, 55 N. D. 707, 215 N. W. 147.

<sup>12</sup> *Harris v. Ashdown Potato Curing Association*, 171 Ark. 399, 284 S. W. 755, 759.

<sup>13</sup> *Bennett v. Lathrop*, 71 Conn. 313, 42 A. 634, 71 Am. St. Rep. 222.

<sup>14</sup> *Webster v. San Joaquin Fruit & Vegetable Growers' Protective Association*, 32 Cal. App. 264, 162 P. 654, 655. See also *Burks v. Weast*, 67 Cal. App. 745, 228 P. 541; *Case v. Kadota Fig Association of Producers*, 207 P. 2d 86 (Cal. D. C. of App.) (dictum).

of course, the debt is of such a nature and has been so contracted as to be binding on the association as a whole \* \* \*. An unincorporated association organized for business or profit is in legal effect a mere partnership so far as the liability of its members to third persons is concerned; and accordingly each member is individually liable as a partner for a debt contracted by the association.

It should be borne in mind that the association involved in this case was organized for business purposes. This case illustrates one of the serious objections to unincorporated associations and, in turn, emphasizes one of the great advantages of an incorporated association in which generally the members are not liable for the debts of the association.

### **Money Must Be Used for Purpose Specified**

In a New Jersey case <sup>15</sup> it was said:

\* \* \* The vote must be for some purpose for which the money was contributed. A majority cannot devote the money of the minority, or even of a single member, to any other purpose without his consent.

The rule that money can be used only for the purpose for which contributed appears settled.<sup>16</sup> In the West Virginia case just cited, a retail butchers' protective association was organized with a constitution which specified the purposes for which money could be used. Through dues paid by the members a fund of \$1,800 was accumulated. There were 24 members of the association. At a regular meeting 20 were present, and by a vote of 12 to 8 an order was passed to distribute all the money in the treasury except \$100 among the members. Certain of the members who opposed this use of the money obtained an injunction preventing the distribution of the money, and the supreme court of the State held that although a majority of the members present at the meeting had voted in favor of the distribution, yet it could not lawfully be diverted from the purpose for which contributed, as set forth in the constitution.

Where certain members of an association formed a corporation this did not operate to transfer the assets of the association to the corporation, over the objection of some of the members.<sup>17</sup>

### **Expulsion of Members**

It was pointed out earlier in this discussion on unincorporated associations that the rights of the members between themselves was a contractual one and that the constitution and bylaws, or either of them, constituted a contract between the members. It follows that if the constitution or bylaws assented to by the members state causes for expulsion from the association, ordinarily the courts would afford no relief if a member were expelled in good faith for such a cause.<sup>18</sup> This is undoubtedly the general rule.<sup>19</sup> However, all rules of the association relative to expulsion must be followed.<sup>20</sup>

The constitution or bylaws of the association may place the entire matter of disciplining, suspending, or expelling members in a committee

<sup>15</sup> *Abels v. McKeen*, 18 N. J. Eq. 462.

<sup>16</sup> *Kalbitzer v. Goodhue*, 52 W. Va. 435, 44 S. E. 264.

<sup>17</sup> *Hamaty v. St. George Ladies' Society*, 280 Mass. 58, 181 N. E. 775. See also *Strong v. Los Nietos & Ranchito Walnut Growers' Association*, 137 Cal. 607, 70 P. 734.

<sup>18</sup> *Connelly v. Masonic Mutual Benefit Association*, 58 Conn. 552, 20 A. 671, 9 L. R. A. 428, 18 Am. St. Rep. 296; 7 C. J. S. Associations, sec. 25.

<sup>19</sup> See preceding note and note in 9 L. R. A. 428.

<sup>20</sup> *Farmer v. Board of Trade of Kansas City*, 78 Mo. App. 557; *Kelly v. Grand Circle Women of Woodcraft*, 40 Wash. 691, 82 P. 1007; 7 C. J. S. Associations, sec. 25.

or like body.<sup>21</sup> Such a provision in the constitution or bylaws, like other legal provisions in such instruments, is binding upon all members assenting to them.

In a case involving an unincorporated communal society, the organization papers of which did not specify any causes for expulsion, it was held, where a member was expelled without just cause, that he was entitled to recover a pro rata part of "his heretofore undivided interest in the property of the society which had been acquired during his membership."<sup>22</sup>

It has been said with reference to unincorporated associations that "\* \* \* courts never interfere, except to ascertain whether or not the proceeding was pursuant to the rules and laws of the society, whether or not the proceeding was in good faith, and whether or not there was anything in the proceeding in violation of the laws of the land."<sup>23</sup> It is believed this states the general rule.

### Withdrawing or Expelled Members Receive Nothing

In the absence of a contract or statute on the subject, the rule appears to be settled that those who withdraw<sup>24</sup> or are expelled<sup>25</sup> from an unincorporated association are not entitled to compensation for their interest in the association and that they thereby lose all rights in the property of the association.<sup>26</sup> Although a majority of the members of an association withdraw, the right of those who remain to continue the association appears clear, and this right carries with it the right to the property of the association.<sup>27</sup> In a Michigan case<sup>28</sup> it was said:

It has been many times decided that persons who withdraw from a voluntary association are not entitled to any portion of its property, and that those who remain have the right to the property of the association and its use so long as any of the members remain, and clearly withdrawing members ought not to decide the right of those not withdrawing to continue the association.

### Dissolution

In the absence of a statutory or contractual provision to the contrary, an unincorporated association can be dissolved only by unanimous consent of the members.<sup>29</sup> Upon the dissolution of an unincorporated association, unless otherwise provided by its rules, its property after payments of its debts should be distributed pro rata among those who were members at the time of such dissolution.<sup>30</sup>

<sup>21</sup> *Harris v. Aiken*, 76 Kan. 516, 92 P. 537, 123 Am. St. Rep. 149.

<sup>22</sup> *Nachtrieb v. The Harmony Settlement*, Federal Case No. 10,003, 17 Fed. Cases 1139.

<sup>23</sup> *Kelly v. Grand Circle Women of Woodcraft*, 40 Wash. 691, 82 P. 1007, 1008; *Burt v. Oneida Community, Ltd.*, 137 N. Y. 346, 33 N. E. 307, 19 L. R. A. 297; 138 N. Y. 649, 34 N. E. 288. See also 4 Am. Jur., p. 471, sec. 25.

<sup>24</sup> *Richardson v. Harsha*, 22 Okla. 405, 98 P. 897. See also *Schwartz v. Duss*, 187 U. S. 8, 23 S. Ct. 4, 47 L. Ed. 53.

<sup>25</sup> *Missouri Bottlers' Association v. Fennerty*, 81 Mo. App. 525; 5 C. J. 1360; 19 R. C. L. 1267.

<sup>26</sup> Cases cited above.

<sup>27</sup> *McFadden v. Murphy*, 149 Mass. 341, 21 N. E. 868; *Altmann v. Benz*, 27 N. J. Eq. 331.

<sup>28</sup> *Walters v. Pittsburgh & Lake Angeline Iron Co.*, 201 Mich. 379, 167 N. W. 834, 837, 1 A. L. R. 624.

<sup>29</sup> *Sommers v. Reynolds*, 103 Mich. 307, 61 N. W. 501; *Parks v. Knickerbocker Trust Co.*, 122 N. Y. S. 521, 137 App. Div. 719. See also *Hamaty v. St. George Ladies' Society*, 280 Mass. 58, 181 N. E. 775; *Strong v. Los Nietos & Ranchito Walnut Growers' Association*, 137 Cal. 607, 70 P. 734.

<sup>30</sup> Cases last cited. But cf. *Atkinson v. Consumer-Farmer Milk Cooperative, Inc.*, 94 N. Y. S. 2d 891.



## Statutes Regulating Cooperatives

THERE is no Federal statute conferring general regulatory or supervisory powers over agricultural cooperatives. As pointed out in the discussion of the Capper-Volstead Act,<sup>31</sup> in certain circumstances the Secretary of Agriculture may institute proceedings against associations under that act. Again, if an association is engaged in abnormal acts or transactions, it may be subject to prosecution under the antitrust statutes. Such associations, if they engage in unfair competition, are subject to action by the Federal Trade Commission.<sup>32</sup> They are likewise amenable to other Federal statutes of general application, such as the many statutes regulating the marketing of farm products<sup>33</sup> and the Robinson-Patman Act,<sup>34</sup> which prohibits, among other things, unjustifiable price discriminations.<sup>35</sup>

Although many States have bureaus or agencies which render service to cooperatives, it is believed that there is no State statute which provides for their regulation and supervision. In general, the situation of cooperatives is comparable to that of other corporations engaged in private business, in contrast with that of public utilities.

It should be kept in mind that a statute, whether State or Federal, covering persons or organizations engaged in business of a particular type, is applicable to cooperatives engaged in such business, unless they are specifically excepted therefrom.<sup>36</sup>

Under many State cooperative statutes, cooperatives, like other private corporations, are required to render reports to a State official.<sup>37</sup>

If a cooperative functions as a licensed public warehouseman, it is subject to regulation by the State or Federal Government, as the case may be. However, it has been held that a warehouse licensed under the Federal

<sup>31</sup> See Capper-Volstead Act, p. 166.

<sup>32</sup> 38 Stat. 717, 15 U. S. C. A. 41.

<sup>33</sup> For a discussion of the legal basis for these statutes and a listing of them, see N. BROOKS, THE WIDE RANGE OF REGULATION, 1954 Yearbook of Agriculture, p. 255 et seq.

<sup>34</sup> 49 Stat. 1526, 15 U. S. C. A. 13.

<sup>35</sup> For cases involving cooperatives: (1) before the National Labor Relations Board, see *N. L. R. B. v. Enid Coop. Creamery Association*, 169 F. 2d 986; *N. L. R. B. v. Edinburg Citrus Association*, 147 F. 2d 353; *Idaho Potato Growers, Inc. v. N. L. R. B.*, 144 F. 2d 295; (2) in reparation cases under the Perishable Agricultural Commodities Act, see *California Fruit Exchange v. Henry*, 89 F. Supp. 580; *Maine Potato Growers, Inc., v. Jos. Martinelli & Company, Inc.*, 3 A. D. 997; (3) in cases involving the Fair Labor Standards Act, see *Farmers Reservoir & Irrigation Co. v. McComb*, 337 U. S. 755, 69 S. Ct. 1274, 93 L. Ed. 1672; *Puerto Rico Tobacco Marketing Cooperative Association v. McComb*, 181 F. 2d 697; *Meeker Cooperative Light & Power Association v. Phillips*, 158 F. 2d 698; *Holly Hill Fruit Products, Inc. v. Addison*, 136 F. 2d 323; *Stephens v. Cotton Producers Association*, 117 F. Supp. 517; *Dallum v. Farmers Cooperative Trucking Association*, 46 F. Supp. 785; *Holt v. Barnesville Farmers Elevator Co.*, 52 F. Supp. 468; and (4) in cases involving World War II regulations, see *Great Northern Coop. Association v. Bowles*, 146 F. 2d 269; *Land O' Lakes Creameries, Inc. v. McNutt*, 132 F. 2d 653; *Porter v. Cokato Cooperative Creamery Association*, 65 F. Supp. 974; *Bowles v. Fruit Growers Coop.*, 61 F. Supp. 745; *Bowles v. Cooperative G. L. F. Farm Products*, 53 F. Supp. 413; *Bowles v. Sebastopol Berry Growers Association*, 4 F. R. D. 502.

<sup>36</sup> *State ex rel. Van Winkle v. Farmers Union Cooperative Creamery*, 160 Ore. 205, 84 P. 2d 471; *West Central Producers Cooperative Association v. Commissioner of Agriculture*, 124 W. Va. 81, 20 S. E. 2d 797; *Farmers Coop. Equity Union Shipping Association v. Public Service Commission*, 245 Wis. 143, 13 N. W. 2d 507. See annotation, LICENSING BUYERS OF FARM PRODUCE, 117 A. L. R. 347.

<sup>37</sup> See sec. 20 of Bingham Cooperative Marketing Act of Kentucky, p. 306 of Appendix.

act is free from regulation under the State act.<sup>38</sup> Likewise, farmers' mutual insurance associations may be subject to State insurance statutes, and to supervision by a State agency.

A question which has frequently arisen is whether a mutual telephone company or a rural electric association is required to obtain a certificate of convenience and necessity from a State commission and to adhere to the rules and regulations promulgated by the commission. The answer to the question will frequently hinge upon whether the association is functioning as a public utility, or is operated as a private company rendering services only for its members. Of course, the terms of the statute are frequently determinative.

A cooperative telephone company which served its members at cost, but which invited the public generally to use its service through pay stations which it maintained, thereby became a public utility and was subject to regulation.<sup>39</sup>

In Missouri it was held that the public service commission did not have jurisdiction over a mutual telephone company operating on an assessment basis, "insofar as its relations with its members are concerned," and that it was a public utility company only to the extent that it afforded telephonic communication for hire to the public.<sup>40</sup>

A rural electric cooperative, organized on a nonstock basis, which had not "dedicated or devoted its facilities to public use \* \* \*"; which did "not conduct its operations for gain to itself, or for the profit of investing stockholders, in the sense in which those terms are commonly understood"; and which was "a league of individuals associated together in corporate form for the sole purpose of producing and procuring for themselves a needed service at cost," was held not to be a public service corporation within the purview of the public service commission law of the State.<sup>41</sup>

Another class of cases arises in connection with Federal and State motor-carrier acts, and the question usually involves whether a particular association is functioning as a public or contract carrier. Here, again, the terms of the applicable statute will frequently indicate the answer to the question.

An association of producers engaged in the hauling by motor carriers of the agricultural products of its members and in the hauling of farm supplies for them may be regulated,<sup>42</sup> but in some of the States the statutes regulating motor carriers specifically exempt such associations. Such

<sup>38</sup> *In re Farmers Cooperative Association*, 69 S. D. 191, 8 N. W. 2d 557.

<sup>39</sup> *Gilman v. Somerset Farmers' Coop. Telephone Co.*, 129 Me. 243, 151 A. 440. See generally annotation, COOPERATIVE AS PUBLIC UTILITY, 132 A. L. R. 1495, 1496.

<sup>40</sup> *State ex rel. Lohman & Farmers' Mutual Telephone Co. v. Brown*, 323 Mo. 818, 19 S. W. 2d 1048. See also *Limestone Rural Telephone Co. v. Best*, 56 Okla. 85, 155 P. 901; *State v. Southern Elkhorn Telephone Co.*, 106 Neb. 342, 183 N. W. 562; *People ex rel. Knowlton v. Orange County Farmers' and Merchants' Association*, 56 Cal. App. 205, 204 P. 873.

<sup>41</sup> *Inland Empire Rural Electrification, Inc. v. Department of Public Service of Washington*, 199 Wash. 527, 92 P. 2d 258, 263, 264. For cases of similar import see *Garkane Power Co., Inc. v. Public Service Commission*, 98 Utah 466, 100 P. 2d 571. But see contra, *In re Harrison Rural Electrification Association, Inc.*, 24 P. U. R. (N. S.) 7.

<sup>42</sup> See "Persons hauling commodities for cooperative purchasing or marketing associations, or their members, as common carriers," 98 A. L. R. 226; "Jurisdiction of public service commission over carriers transporting by motor trucks or busses," 103 A. L. R. 268; "Validity and applicability of statutes relating to use of highway by private motor carriers and contract motor carriers for hire," 109 A. L. R. 550; "Construction and application of exemption or exception provisions of statutes requiring registration of motor vehicles, etc.," 91 A. L. R. 422.

exemptions are valid.<sup>43</sup> On the other hand, where the statutes do not exempt such associations or are not drawn in such a way as to be inapplicable to cooperatives, the associations are subject thereto.<sup>44</sup> The exemption of motor vehicles used exclusively in the transportation of agricultural or dairy products from the operation of a statute requiring private carriers for hire to obtain licenses has been upheld, regardless of whether the trucks are the property of the producer of such products or of another.<sup>45</sup> It has been held that a person employed by a cooperative to haul by motor carrier only the products of its members may not, by statute, be converted into a common carrier.<sup>46</sup>

The Federal Motor Carrier Act, 1935, as amended <sup>47</sup> provides:

SEC. 203. (b) Nothing in this part, except the provisions of section 204 relative to qualifications and maximum hours of service of employees and safety of operation or standards of equipment shall be construed to include \* \* \* (4a) motor vehicles controlled and operated by any farmer, and used in the transportation of his agricultural commodities and products thereof, or in the transportation of supplies to his farm; or (4b) motor vehicles controlled and operated by a cooperative association as defined in the Agricultural Marketing Act, approved June 15, 1929, as amended \* \* \*.

Although a cooperative as defined in the Agricultural Marketing Act as amended, by reason of the language just quoted, is relieved of the necessity for obtaining a certificate of public convenience and necessity,<sup>48</sup> a permit or a license, other provisions relative to qualifications and maximum hours of service of employees and safety of operation and standards of equipment are applicable to cooperatives operating motor vehicles in interstate or foreign commerce as defined in section 203 (a) (10) and (11), respectively, of that act.

Since the Civil Aeronautics Act <sup>49</sup> contains no exemption similar to the one quoted above from the Motor Carrier Act, it was held that a flower growers' shipping cooperative was subject to the former act's certification requirement and the Civil Aeronautics Board's freight forwarder regulations.<sup>50</sup>

It should be noted that the Supreme Court of the United States has held <sup>51</sup> that the jurisdiction of the Interstate Commerce Commission over employees, as that term is used in section 204 (a) (1) and (2) of that act, "is limited to those employees whose activities affect the safety of opera-

<sup>43</sup> *Baker v. Glenn*, 2 F. Supp. 880.

<sup>44</sup> *Parlett Cooperative, Inc. v. Tidewater Lines, Inc.*, 164 Md. 405, 165 A. 313; *North Shore Fish and Freight Co. v. North Shore Business Men's Trucking Association*, 195 Minn. 336, 263 N. W. 98.

<sup>45</sup> *Aero Mayflower Transit Co. v. Georgia Public Service Commission*, 295 U. S. 285, 55 S. Ct. 709, 79 L. Ed. 1439. But see *Smith v. Cahoon*, 283 U. S. 553, 51 S. Ct. 582, 75 L. Ed. 1264.

<sup>46</sup> *Dairymen's Coop. Sales Association v. Public Service Commission*, 318 Pa. 381, 177 A. 770, 98 A. L. R. 218. See also *Michigan Public Utilities Commission v. Duke*, 266 U. S. 570, 45 S. Ct. 191, 69 L. Ed. 445, 36 A. L. R. 1105. But see *Affiliated Service Corporation v. Public Utilities Commission of Ohio*, 127 Ohio St. 47, 186 N. E. 703, 103 A. L. R. 264; *Davis v. People*, 79 Colo. 642, 247 P. 801.

<sup>47</sup> 49 Stat. 545, 49 U. S. C. A. 301, 303.

<sup>48</sup> *Interstate Commerce Commission v. Jamestown Farmers Union Federated Coop. Transp. Association*, 151 F. 2d 403, affirming 57 F. Supp. 749. Cf. *United States v. Pacific Coast Wholesalers' Association*, 338 U. S. 689, 70 S. Ct. 411, 94 L. Ed. 474.

<sup>49</sup> 52 Stat. 973; 49 U. S. C. A. 401 et seq.

<sup>50</sup> *Consolidated Flower Shipments, Inc.—Bay Area v. Civil Aeronautics Board*, 213 F. 2d 814.

<sup>51</sup> *United States v. American Trucking Associations*, 310 U. S. 534, 60 S. Ct. 1059, 84 L. Ed. 1345.



tion. The Commission has no jurisdiction to regulate the qualifications or hours of service of any other." In other words, the Fair Labor Standards Act <sup>52</sup> in proper cases is applicable to all employees other than "those employees whose activities affect the safety of operation."

Farmers engaged in the hauling of their own products appear either to be exempt from the various statutes regulating motor carriers, or such statutes by their terms are not applicable to them. In view of this fact, it is sometimes urged that inasmuch as individual farmers are not subject to a motor carrier act, an association of such farmers engaged in the hauling of their products collectively should not be subject thereto, but no case is known in which this argument has prevailed.<sup>53</sup> It is generally held that one employed by a cooperative to haul only the products of its members is not a common carrier;<sup>54</sup> but it has been held otherwise.<sup>55</sup>

Any cooperative, before it engages in the motor carrier business, should ascertain its status with respect to the Federal Motor Carrier Act and to like applicable State statutes. An organization should not assume that it is exempt, because the assumption may prove incorrect. Again, even if it is found that the Federal Motor Carrier Act does not apply to motor vehicles controlled and operated by a cooperative as defined in the Agricultural Marketing Act, as amended, an association should ascertain and carefully observe the rules and regulations which the Interstate Commerce Commission has adopted to "permit safety of operation" and any conditions which it may have prescribed relative to "qualifications and maximum hours of service of employees and standards of equipment." Correspondence regarding the Federal Motor Carrier Act and requests for copies of such rules and regulations may be addressed to the Interstate Commerce Commission, Washington, D. C., or one of its branch offices.

A fair trade act of Wisconsin, which permitted the manufacturers of trade-marked goods to enter into contracts specifying what the resale price of such products would be, contained a provision specifying that the act "shall not apply to any cooperative society or association not organized for profit," and this exception was held to be unconstitutional, although the statute was otherwise held constitutional. The court said:

That exemption is not confined to merely transactions between such an association or society and its members. It is equally applicable to sales made by such associations or societies in competition with other retail dealers to the public at large, but as to which such exempted associations or societies would be permitted to sell at less than minimum resale prices stipulated under the Fair Trade Act. Thus there would be defeated its "primary aim to protect the property, namely, the good will, of the producer."

It should be noted that if the exception had been upheld it would have barred cooperatives from obtaining the advantage of the statute in connection with the sale of their trade-marked goods.<sup>56</sup>

<sup>52</sup> 52 Stat. 1060, 29 U. S. C. A. 201.

<sup>53</sup> *Rutledge Coop. Association, Inc. v. Baughman*, 153 Md. 297, 138 A. 29, 56 A. L. R. 1042; *Madonna & Shawsville Cooperative Co. of Harford County, Inc. v. West*, 168 Md. 95, 176 A. 611.

<sup>54</sup> *Dairymen's Coop. Sales Association v. Public Service Commission*, 318 Pa. 381, 177 A. 770, 98 A. L. R. 218, and cases therein cited.

<sup>55</sup> *Public Service Commission v. Western Maryland Dairy*, 150 Md. 641, 135 A. 136, writ of error dismissed in 274 U. S. 765, 47 S. Ct. 763, 71 L. Ed. 1334; *West v. Tidewater Express Lines*, 168 Md. 581, 179 A. 176; *Public Utilities Commission of Ohio v. Boughtonville Farmers' Exchange Co.*, 40 Ohio App. 395, 178 N. E. 859; *Davis v. People*, 79 Colo. 642, 247 P. 801.

<sup>56</sup> *Weco Products Company v. Reed Drug Company*, 225 Wis. 474, 274 N. W. 426, 433.

In holding the Growers Cost Guarantee Law of Florida relative to Citrus fruit unconstitutional, the court said: <sup>57</sup>

The testimony also showed that many of the growers had organized cooperative corporations to process their grapefruit. The cooperative did not pay cash for their fruit to these growers, but credited them with the amount of the price of the fruit and were not expected to pay for it unless the market prices enabled them to pay it, and the Commissioner did not enforce payment while requiring payment of the regular canners.

This certainly was discrimination against the canners, and the Commissioner must have construed the act so as to authorize him to do this.

A Texas statute authorized the Commissioner of Agriculture of the State to limit or provide methods for limiting the amount of citrus fruit which might be marketed in intrastate commerce, but it was held that this did not authorize him to fix minimum prices for citrus fruit. <sup>58</sup>

Of course, the State has the inherent power to enact legislation to promote the public welfare, and associations handling agricultural products are frequently called upon to comply with various health regulations. Of recent years, this power has been extended to comprehend various control programs on the part of the Federal and State governments in connection with agricultural products. In California, it has been held that an agricultural pro rate statute was constitutional. <sup>59</sup>

## Federal Statutes Mentioning Cooperatives

THIS section has been prepared for the purpose of referring briefly to all the important Federal statutes that specifically mention cooperatives. For convenience, the material will be presented under topical headings.

### Tax Statutes

It is believed that the first Federal statute <sup>60</sup> to refer to farmer cooperatives was the War Revenue Act of 1898, <sup>61</sup> which had a section providing for stamp taxes, which section contained the following exception:

*Provided further*, that the provisions of this section shall not apply to any fraternal, beneficiary society, or order, or farmers' purely local cooperative company or association, or employees' relief associations operated on the lodge system, or local cooperation plan, organized and conducted solely by the members thereof for the exclusive benefit of its members and not for profit.

The next Federal statute to mention agricultural organizations was the Corporation Tax Statute of 1909. <sup>62</sup> Section 38 of that statute, which placed a tax on corporations, joint stock companies or associations, had a proviso stating:

\* \* \* that nothing in this section contained shall apply to labor, agricultural or horticultural organizations, or to fraternal beneficiary societies, orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations, and

<sup>57</sup> *Lakeland Highlands Canning Company, Inc. v. Nathan Mayo, as Commissioner of Agriculture of the State of Florida*, 28 F. Supp. 44, 47.

<sup>58</sup> *McDonald v. American Fruit Growers*, 126 S. W. 2d 83 (Tex. Civ. App.), appeal dismissed, 127 S. W. 2d 291. See also *Van Winkle v. Fred Meyer, Inc.*, 151 Ore. 455, 49 P. 2d 1140.

<sup>59</sup> *Agricultural Pro Rate Commission v. Superior Court*, 5 Cal. 2d 550, 55 P. 2d 495.

<sup>60</sup> In enacting the Sherman Antitrust Act in 1890 Congress rejected an amendment to exempt agricultural associations. See *Monopoly and Restraint of Trade*, p. 156.

<sup>61</sup> 30 Stat. 448, 461.

<sup>62</sup> 36 Stat. 11, 113.

dependents of such members, nor to domestic building and loan associations, organized and operated exclusively for the mutual benefit of their members \* \* \*.

The Supreme Court, in discussing the constitutionality of the Corporation Tax Statute, said:

As to the objections that certain organizations, labor, agricultural and horticultural, fraternal and benevolent societies, loan and building associations, and those for religious, charitable or educational purposes, are excepted from the operation of the law, we find nothing in them to invalidate the tax. As we have had frequent occasion to say, the decisions of this court from an early date to the present time have emphasized the right of Congress to select the objects of excise taxation, and within this power to tax some and leave others untaxed, must be included the right to make exemptions such as are found in this act.<sup>63</sup>

Section G (a) of the Income Tax Statute of 1913<sup>64</sup> contained the following proviso:

*Provided, however,* That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares.

In discussing these exemptions, the Supreme Court said: <sup>65</sup>

The statute provides that the tax should not apply to enumerated organizations or corporations, such as labor, agricultural or horticultural organizations, mutual savings banks, etc., and the argument is that as the amendment authorized a tax on incomes "from whatever source derived," by implication it excluded the power to make these exemptions. But this is only a form of expressing the erroneous contention as to the meaning of the amendment, which we have already disposed of. And so far as this alleged illegality is based on other provisions of the Constitution, the contention is also not open, since it was expressly considered and disposed of in *Flint v. Stone Tracy Co.*

Subsequent provisions of the income tax statutes of the United States as they pertain to farmer cooperatives are cited and discussed in the part on Federal Income Taxes, at page 195.

In 1926, the following provision was added to the statute under which dealers in leaf tobacco were required to register and render various reports and accounts to the Collector of Internal Revenue of their districts regarding the sale of leaf tobacco:

\* \* \* a farmer or grower of tobacco or a tobacco growers' cooperative association shall not be regarded as a dealer in leaf tobacco in respect to the leaf tobacco produced by him or handled by such association: *Provided*, That such cooperative associations shall be required to keep available records of all purchases and sales of tobacco, such records to be open to inspection by the agents of the Government. As used in this subsection the term "tobacco growers' cooperative association" means an association of farmers or growers of tobacco organized and operated as sales agent for the purpose of marketing the tobacco produced by its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity and quality of tobacco furnished by them.<sup>66</sup>

### Statutes Providing Credit Facilities

The War Finance Corporation Act was enacted in 1918.<sup>67</sup> In an amendment of 1921,<sup>68</sup> there was the following reference to cooperatives:

<sup>63</sup> *Flint v. Stone Tracy Co.*, 220 U. S. 107, 173, 31 S. Ct. 342, 55 L. Ed. 389.

<sup>64</sup> 38 Stat. 114, 172.

<sup>65</sup> *Brushaber v. Union Pacific Railroad Co.*, 240 U. S. 1, 21, 36 S. Ct. 236, 60 L. Ed. 493, L. R. A. 1917D 414, Ann. Cas. 1917B 713.

<sup>66</sup> 44 Stat. 91, 26 U. S. C. A. 2050 (b). For subsequent statutes see 55 Stat. 225 and sec. 5702 of the Internal Revenue Code of 1954; 26 U. S. C. A. 5702.

<sup>67</sup> 40 Stat. 506. For history see note to 15 U. S. C. A. 331-374. The corporation was abolished in 1939 and liquidated by the Secretary of the Treasury, 45 Stat. 1442.

<sup>68</sup> 42 Stat. 181, 182.



SEC. 24. Whenever in the opinion of the Board of Directors of the Corporation the public interest may require it, the Corporation shall be authorized and empowered to make advances upon such terms not inconsistent with this Act as it may determine to any bank, banker, or trust company in the United States or to any cooperative association of producers in the United States which may have made advances for agricultural purposes, including the breeding, raising, fattening, and marketing of livestock, or may have discounted or rediscounted notes, drafts, bills of exchange or other negotiable instruments issued for such purposes. Such advance or advances may be made upon promissory note or notes, or other instrument or instruments, in such form as to impose on the borrowing bank, banker, trust company, or cooperative association a primary and unconditional obligation to repay the advance at maturity with interest as stipulated therein, and shall be fully and adequately secured in each instance by indorsement, guaranty, pledge, or otherwise. Such advances may be made for a period not exceeding one year and the Corporation may from time to time extend the time of payment of any such advance through renewals, substitution of new obligations or otherwise, but the time for the payment of any such advance shall not be extended beyond three years from the date upon which such advance was originally made. The aggregate of advances made to any bank, banker, trust company, or cooperative association shall not exceed the amount remaining unpaid of the advances made by such bank, banker, trust company, or cooperative association for purposes herein described.

The Federal Reserve Act,<sup>69</sup> as originally enacted in 1913, in section 13 authorized any Federal reserve bank, subject to certain conditions, to discount "notes, drafts, and bills of exchange issued or drawn for agricultural \* \* \* purposes."

In 1923<sup>70</sup> the provisions with reference to agricultural paper were amended, and there was added a further amendment (sec. 13a) which provided that:

Notes, drafts, bills of exchange or acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products shall be deemed to have been issued or drawn for an agricultural purpose, within the meaning of this section, if the proceeds thereof have been or are to be advanced by such association to any members thereof for an agricultural purpose, or have been or are to be used by such association in making payments to any members thereof on account of agricultural products delivered by such members to the association, or if such proceeds have been or are to be used by such association to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market or marketing of any agricultural product handled by such association for any of its members: *Provided*, That the express enumeration in this paragraph of certain classes of paper of cooperative marketing associations as eligible for rediscount shall not be construed as rendering ineligible any other class of paper of such associations which is now eligible for rediscount.

Congress also enacted in 1923 a statute providing for the incorporation of 12 institutions to be known as the "Federal Intermediate Credit Banks."<sup>71</sup> These banks were authorized to make loans, subject to certain conditions and restrictions, on staple agricultural products and on livestock, to cooperatives.

The Agricultural Marketing Act was passed in 1929.<sup>72</sup> It created the Federal Farm Board and authorized that board to make loans to associations of farmers. Section 1 of that act provides:

That it is hereby declared to be the policy of Congress to promote the effective merchandising of agricultural commodities in interstate and foreign commerce, so that the industry of agriculture will be placed on a basis of economic equality with other industries, and to that end to protect, control, and stabilize the currents of interstate and foreign commerce in the marketing of agricultural commodities and their food products \* \* \*.

<sup>69</sup> 38 Stat. 251, 12 U. S. C. A. 221 *et seq.*

<sup>70</sup> 42 Stat. 1479, 1480, 12 U. S. C. A. 351.

<sup>71</sup> 42 Stat. 1454, 12 U. S. C. A. 1021.

<sup>72</sup> 46 Stat. 11, 12 U. S. C. A. 1141.

(3) by encouraging the organization of producers into effective associations or corporations under their own control for greater unity of effort in marketing and by promoting the establishment and financing of a farm marketing system of producer-owned and producer-controlled cooperative associations and other agencies.

The act also authorized the Federal Farm Board to encourage "the organization, improvement in methods, and development of effective cooperative associations."

The Farm Credit Act of 1933<sup>73</sup> authorized the organization of 12 regional banks for cooperatives and the Central Bank for Cooperatives, for the purpose of making loans to cooperatives meeting the definition of such associations, as contained in section 15 (a) of the Agricultural Marketing Act, as amended, which definition<sup>74</sup> reads as follows:

As used in this act, the term "cooperative association" means any association in which farmers act together in processing, preparing for market, handling, and/or marketing the farm products of persons so engaged, and also means any association in which farmers act together in purchasing, testing, grading, processing, distributing, and/or furnishing farm supplies and/or farm business services: *Provided, however,* That such associations are operated for the mutual benefit of the members thereof as such producers or purchasers and conform to one or both of the following requirements:

First. That no member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein; and

Second. That the association does not pay dividends on stock or membership capital in excess of 8 per centum per annum.

And in any case to the following:

Third. That the association shall not deal in farm products, farm supplies, and farm business services with or for nonmembers in an amount greater in value than the total amount of such business transacted by it with or for members. All business transacted by any cooperative association for or on behalf of the United States or any agency or instrumentality thereof shall be disregarded in determining the volume of member and nonmember business transacted by such association.

The Rural Electrification Act of 1936<sup>75</sup> contains the following reference to cooperatives:

The Administrator is authorized and empowered, from the sums hereinbefore authorized, to make loans to persons, corporations, States, Territories, and subdivisions and agencies thereof, municipalities, peoples' utility districts and cooperative nonprofit, or limited-dividend associations organized under the laws of any State or Territory of the United States, for the purpose of financing the construction and operation of generating plants, electric transmission and distribution lines or systems for the furnishing of electric energy to persons in rural areas who are not receiving central station service: *Provided, however,* That the Administrator, in making such loans, shall give preference to States, Territories, and subdivisions and agencies thereof, municipalities, peoples' utility districts, and cooperative, nonprofit, or limited dividend associations, the projects of which comply with the requirements of this act. \* \* \*

## Antitrust and Related Statutes

The Clayton Act<sup>76</sup> was enacted in 1914. Section 6 of that act purported to give agricultural associations, which met certain conditions, immunity under the antitrust laws.<sup>77</sup>

The appropriations acts for the Department of Justice beginning with the fiscal year ending June 30, 1914,<sup>78</sup> and up to and including the appro-

<sup>73</sup> 48 Stat. 257, 261, 12 U. S. C. A. 1134, 1134 (f).

<sup>74</sup> 49 Stat. 317, 12 U. S. C. A. 1141 (j) (a).

<sup>75</sup> 49 Stat. 1363, 1365. For current language, which is substantially the same, see 7 U. S. C. A. 904.

<sup>76</sup> 38 Stat. 730, 15 U. S. C. A. 12.

<sup>77</sup> See p. 165 for a discussion of sec. 6 of the Clayton Act.

<sup>78</sup> 38 Stat. 53.

priation for the fiscal year ending June 30, 1928,<sup>79</sup> contained the following provision relative to cooperatives:

Enforcement of antitrust laws. For the enforcement of antitrust laws \* \* \* *provided further*, that no part of this appropriation shall be expended for the prosecution of producers of farm products and associations of farmers who cooperate and organize in an effort to and for the purpose to obtain and maintain a fair and reasonable price for their products.

The Capper-Volstead Act became a law in 1922.<sup>80</sup> The object of this law was to permit associations of farmers, corporate or otherwise, and formed with or without capital stock, that met the conditions prescribed therein, to organize and operate in a normal manner without rendering themselves liable under the antitrust statutes as combinations in restraint of trade.<sup>81</sup>

The Robinson-Patman Act,<sup>82</sup> enacted in 1936, relating to price discrimination between purchasers, provides in section 4 thereof that:

Nothing in this act shall prevent a cooperative association from returning to its members, producers, or consumers the whole, or any part of, the net earnings or surplus resulting from its trading operations, in proportion to their purchases or sales from, to, or through the association.

### Regulatory Statutes

Section 26 of a statute enacted in 1917 entitled, "An act to provide further for the national security and defense by encouraging the production, conserving the supply, and controlling the distribution of food products and fuel"<sup>83</sup> prohibited the hoarding of food and contained provisos reading as follows:

*Provided*, That any storing or holding by any farmer, gardener, or other person of the products of any farm, garden, or other land cultivated by him shall not be deemed to be a storing or holding within the meaning of this act: *Provided further*, That farmers and fruit growers, cooperative and other exchanges, or societies of a similar character shall not be included within the provisions of this section.<sup>84</sup>

The Packers and Stockyards Act,<sup>85</sup> was enacted in 1921. By this act Congress gave the Secretary of Agriculture a certain degree of regulatory authority over stockyards and those doing business therein. Section 306 (f) of that act provides that persons carrying on the business of a stockyard owner or market agency must file and publish their rates, and prohibits the making of rebates by them. In parentheses it is stated:

(but this shall not prohibit a cooperative association of producers from bona fide returning to its members, on a patronage basis, its excess earnings on their livestock, subject to such regulations as the Secretary may prescribe); \* \* \*.

The Future Trading Act, which was enacted in 1921,<sup>86</sup> gave the Secretary of Agriculture regulatory power over boards of trade and contained

<sup>79</sup> 44 Stat. 1194.

<sup>80</sup> 42 Stat. 388, 7 U. S. C. A. 291.

<sup>81</sup> For construction of the Capper-Volstead Act, see *United States v. Borden Company*, 308 U. S. 188, 60 S. Ct. 182, 84 L. Ed. 181, reversing 28 F. Supp. 177. See also discussion of the Capper-Volstead Act on p. 166.

<sup>82</sup> 49 Stat. 1526, 1528, 15 U. S. C. A. 13.

<sup>83</sup> 40 Stat. 276, 286.

<sup>84</sup> This was a war measure and sec. 24 (p. 283) provided: "That the provisions of this act shall cease to be in effect when the existing state of war between the United States and Germany shall have terminated, and the fact and date of such termination shall be ascertained and proclaimed by the President."

<sup>85</sup> 42 Stat. 159, 165, 7 U. S. C. A. 181. The Supreme Court held this act constitutional in the case of *Stafford v. Wallace*, 258 U. S. 495, 42 S. Ct. 397, 66 L. Ed. 735, 23 A. L. R. 229.

<sup>86</sup> 42 Stat. 187.



provisions with respect to the admission of cooperatives to boards of trade similar to those provided for in the Grain Futures Act,<sup>87</sup> which was subsequently enacted and which will be discussed later. The Future Trading Act was held unconstitutional because it involved a wrongful use of the taxing power of Congress.<sup>88</sup>

In 1922, the Grain Futures Act<sup>89</sup> based upon the interstate commerce power, was enacted. This act conferred regulatory power on the Secretary of Agriculture with respect to boards of trade. It forbade the exclusion from any board of trade that was designated as a contract market of the duly authorized representatives of any association of producers meeting the requirements of the statute. Section 5 (e) further provides:

That no rule of a contract market shall forbid or be construed to forbid the return on a patronage basis by such cooperative association to its bona fide members of moneys collected in excess of the expense of conducting the business of such association.

In a case involving the constitutionality of this statute, the Supreme Court said:<sup>90</sup>

The next provision of the act which is attacked as invalid is that which forbids a board, designated as a contract market, from excluding from membership in, and all privileges on, its exchanges any duly authorized representative of a lawfully formed and conducted association of producers having adequate financial responsibility, engaged in the cash grain business, and complying or agreeing to comply with the terms and conditions lawfully imposed on the other members, and which bars any rule forbidding the return by such association of the commissions of its representative, less expenses, to the *bona fide* members of the cooperative association in proportion to their consignments of grain to the exchange. It is said that this will impair the value of membership in the board and will take the property of the members without due process of law.

The Board of Trade conducts a business which is affected with a public interest and is, therefore, subject to reasonable regulation in the public interest. \* \* \* The incidental effect which such reasonable rules may have, if any, in lowering the value of memberships does not constitute a taking, but is only a reasonable regulation in the exercise of the police power of the National Government. Congress evidently deems it helpful in the preservation of the vital function which such a board of trade exercises in interstate commerce in grain that producers and shippers should be given an opportunity to take part in the transactions in this world market through a chosen representative. Nor do we see why the requirement that the relation between them and this representative, looking to economy of participation on their part by a return of patronage dividends, should not be permissible because facilitating closer participation by the great body of producers in transactions of the Board which are of vital importance to them.

The Grain Futures Act was amended in 1936 and the title was changed to the Commodity Exchange Act.<sup>91</sup> In the later act, the original provisions concerning the admission of the duly authorized representatives of cooperatives to boards of trade were expanded and strengthened.

In 1927 Congress enacted a statute<sup>92</sup> forbidding, subject to certain conditions, boards of trade and exchanges on which agricultural products were bought and sold from excluding the duly authorized representative of any lawfully formed and conducted cooperative "composed substantially of producers of agricultural products." This statute contains a provision identical to the provision heretofore quoted from the Grain Futures

<sup>87</sup> 42 Stat. 998.

<sup>88</sup> *Hill v. Wallace*, 259 U. S. 44, 42 S. Ct. 453, 66 L. Ed. 822.

<sup>89</sup> 42 Stat. 998, 1001.

<sup>90</sup> *Board of Trade of the City of Chicago v. Olsen*, 262 U. S. 1, 40, 43 S. Ct. 470, 67 L. Ed. 839.

<sup>91</sup> 49 Stat. 1491, 7 U. S. C. A. 1.

<sup>92</sup> 44 Stat. 1423, 15 U. S. C. A. 431.

Act, providing that no rule of a board of trade should be construed to prevent the paying of patronage refunds by an association of producers.

Section 3 (a) of the Securities Act of 1933<sup>93</sup> deals with exempted securities, and paragraph (5) of that section reads:

Any security issued by a building and loan association, homestead association, savings and loan association, or similar institution, substantially all the business of which is confined to the making of loans to members (but the foregoing exemption shall not apply with respect to any such security where the issuer takes from the total amount paid or deposited by the purchaser, by way of any fee, cash value or other device whatsoever, either upon termination of the investment at maturity or before maturity, an aggregate amount in excess of 3 per centum of the face value of such security), or any security issued by a farmers' cooperative association as defined in paragraphs (12), (13), and (14) of section 103 of the Revenue Act of 1932; \* \* \*.

The Motor Carrier Act, enacted in 1935,<sup>94</sup> provides in section 203 (b) that nothing—

\* \* \* except the provisions of section 204 relative to qualifications and maximum hours of service of employees and safety of operation or standards of equipment shall be construed to include \* \* \* (4a) motor vehicles controlled and operated by any farmer, and used in the transportation of his agricultural commodities and products thereof, or in the transportation of supplies to his farm; or (4b) motor vehicles controlled and operated by a cooperative association as defined in the Agricultural Marketing Act, approved June 15, 1929, as amended; \* \* \*.

The Bituminous Coal Conservation Act of 1935<sup>95</sup> contained the following language:

It shall not be an unfair method of competition or a violation of the code or any requirement of this Act (1) to sell to or through any bona fide and legitimate farmer's cooperative organization duly organized under the laws of any State, Territory, the District of Columbia, or the United States whether or not such organization grants rebates, discounts, patronage dividends, or other similar benefits to its members, (2) to sell through any intervening agency to any such cooperative organization, or (3) to pay or allow to any such cooperative organization or to any such intervening agency any discount, commission, rebate, or dividend ordinarily paid or allowed, or permitted by the code to be paid or allowed, to other purchasers for purchases in wholesale or middleman quantities.

The act was subsequently held unconstitutional<sup>96</sup> and was repealed by the Bituminous Coal Act of 1937,<sup>97</sup> which, however, reenacted the language quoted above.<sup>98</sup> It has been held that the phrase "a bona fide and legitimate farmers' cooperative," as used in the act, does not include a regional cooperative which had consumer cooperatives among its membership.<sup>99</sup>

While the Agricultural Marketing Agreement Act of 1937 might properly be discussed here, as it is so closely related to the Agricultural Adjustment Act it is treated under the next topical heading.

## **Agricultural Adjustment and Soil Conservation Statutes**

The original Agricultural Adjustment Act was enacted in 1933.<sup>1</sup> Section 8 of that act contained the following provisions:

<sup>93</sup> 48 Stat. 74, 76; 15 U. S. C. A. 77a-77aa, 77c (5).

<sup>94</sup> 49 Stat. 543, 545, 49 U. S. C. A. 301. See discussion on p. 244.

<sup>95</sup> 49 Stat. 991, 1000; 15 U. S. C. A. 801.

<sup>96</sup> *Carter v. Carter Coal Co.*, 298 U. S. 238, 56 S. Ct. 855, 80 L. Ed. 1160.

<sup>97</sup> 50 Stat. 90, 15 U. S. C. A. 850.

<sup>98</sup> 50 Stat. 72, 15 U. S. C. A. 833.

<sup>99</sup> *Midland Cooperative Wholesale v. Ickes*, 125 F. 2d 618.

<sup>1</sup> 48 Stat. 31. The present Agricultural Adjustment Act is contained in 7 U. S. C. A. 601 to 659, inclusive.

In order to effectuate the declared policy, the Secretary of Agriculture shall have power \* \* \*.

(2) To enter into marketing agreements with processors, associations of producers, and others engaged in the handling, in the current of interstate or foreign commerce of any agricultural commodity or product thereof, after due notice and opportunity for hearing to interested parties. The making of any such agreement shall not be held to be in violation of any of the antitrust laws of the United States, and any such agreement shall be deemed to be lawful: *Provided*, That no such agreement shall remain in force after the termination of this act. For the purpose of carrying out any such agreement the parties thereto shall be eligible for loans from the Reconstruction Finance Corporation under section 5 of the Reconstruction Finance Corporation Act. Such loans shall not be in excess of such amounts as may be authorized by the agreements.

(3) To issue licenses permitting processors, associations of producers, and others to engage in the handling, in the current of interstate or foreign commerce, of any agricultural commodity or product thereof, or any competing commodity or product thereof. Such licenses shall be subject to such terms and conditions, not in conflict with existing acts of Congress or regulations pursuant thereto, as may be necessary to eliminate unfair practices or charges that prevent or tend to prevent the effectuation of the declared policy and the restoration of normal economic conditions in the marketing of such commodities or products and the financing thereof. The Secretary of Agriculture may suspend or revoke any such license, after due notice and opportunity for hearing, for violations of the terms or conditions thereof. Any order of the Secretary suspending or revoking any such license shall be final if in accordance with law. Any such person engaged in such handling without a license as required by the Secretary under this section shall be subject to a fine of not more than \$1,000 for each day during which the violation continues.

The act, as amended, contains several other references to cooperatives, among which is section 610 (b) (1), 7 U. S. C. A., reading as follows:

The Secretary of Agriculture is authorized to establish, for the more effective administration of the functions vested in him by this chapter, State and local committees, or associations of producers, and to permit cooperative associations of producers, when in his judgment they are qualified to do so, to act as agents of their members and patrons in connection with the distribution of payments authorized to be made under section 608 of this title. The Secretary, in the administration of this chapter, shall accord such recognition and encouragement to producer-owned and producer-controlled cooperative associations as will be in harmony with the policy toward cooperative associations set forth in existing acts of Congress, and as will tend to promote efficient methods of marketing and distribution.

These and other sections of the Agricultural Adjustment Act were amended in 1935.<sup>2</sup> Following an adverse decision by the Supreme Court of the United States<sup>3</sup> in a case involving the payment of processing taxes under the Agricultural Adjustment Act, the sections of the original act, as amended, which dealt with matters other than processing taxes were reenacted in the Agricultural Marketing Agreement Act of 1937.<sup>4</sup>

The following provision which appeared in the Agricultural Adjustment Act as amended was adopted by the Agricultural Marketing Agreement Act:

The Secretary, in the administration of this chapter, shall accord such recognition and encouragement to producer-owned and producer-controlled cooperative associations as will be in harmony with the policy toward cooperative associations set forth in existing acts of Congress, and as will tend to promote efficient methods of marketing and distribution.<sup>5</sup>

<sup>2</sup> 49 Stat. 750. The licensing section, 8 (3), was omitted and the other sections were amended.

<sup>3</sup> *United States v. Butler*, 297 U. S. 1, 56 S. Ct. 312, 80 L. Ed. 477, 102 A. L. R. 914.

<sup>4</sup> 50 Stat. 246.

<sup>5</sup> 48 Stat. 37, 49 Stat. 767, 50 Stat. 246, 7 U. S. C. A. 610 (b) (1).



This language was before the United States Supreme Court in the case of the *United States v. Rock Royal Cooperative, Inc.*<sup>6</sup> and with regard thereto, Mr. Justice Reed stated:

These agricultural cooperatives are the means by which farmers and stockmen enter into the processing and distribution of their crops and livestock. The distinctions between such cooperatives and business organizations have repeatedly been held to justify different treatment. \* \* \*

The producer cooperative seeks to return to its members the largest possible portion of the dollar necessarily spent by the consumer for the product with deductions only for modest distribution costs, without profit to the membership cooperative and with limited profit to the stock cooperative. It is organized by producers for their mutual benefit. For that reason, it may be assumed that it will seek to distribute the largest amounts to its patrons.

The commodity handled by a cooperative corresponds for some purposes to the capital of a business corporation. Either may cut sale prices below cost, one as long as its members will deliver, the other as long as its assets permit. When proprietary corporations lower sales prices, they naturally seek to lower purchase prices. Their profit depends on spread. On the other hand, the cooperative cannot pass the reduction. All the selling price less expense is available for distribution to its patrons. As its own members bear the burden of price cutting, it was reasonable to exempt it from the payment of the fixed price. The cooperative member measures his return by the market or uniform price the business handler pays. In commodities with the wide market of staple dairy products, quotations are readily available. If distributions do not equal open prices, the cooperators' reactions would parallel those of stockholders of losing businesses. Neither the act nor the order protects anyone from lawful competition, nor is it essential that they should do so. We do not find an unreasonable discrimination in excepting producers' cooperatives from the requirement to pay a uniform price.

In many of the other agricultural statutes administered by the United States Department of Agriculture, there are references more or less significant to cooperatives.<sup>7</sup>

The initial Soil Erosion Act, enacted in 1935,<sup>8</sup> contained no reference to cooperatives. This act became the Soil Conservation and Domestic Allotment Act by virtue of amendment made in 1936, but it was not until 1938 that specific mention of cooperatives was made by this act. At that time, section 8 (b) <sup>9</sup> was amended to include the following:

In carrying out the provisions of this section, the Secretary shall, as far as practicable, protect the interests of tenants and sharecroppers; is authorized to utilize the agricultural extension service and other approved agencies; shall accord such recognition and encouragement to producer-owned and producer-controlled cooperative associations as will be in harmony with the policy toward cooperative associations set forth in existing Acts of Congress and as will tend to promote efficient methods of marketing and distribution; shall not have power to acquire any land or any right or interest therein; shall, in every practicable manner, protect the interests of small producers; and shall in every practical way encourage and provide for soil-conserving and soil-rebuilding practices rather than the growing of soil-depleting crops.

The Agricultural Adjustment Act of 1938<sup>10</sup> contains a number of references to cooperatives. In connection with the adjustment in freight rates, it is provided:

The Secretary is authorized to cooperate with and assist cooperative associations of farmers making complaint to the Interstate Commerce Commission with respect to rates, charges, tariffs, and practices relating to the transportation of farm products.<sup>11</sup>

<sup>6</sup> 307 U. S. 533, 563, 564, 59 S. Ct. 993, 83 L. Ed. 1446.

<sup>7</sup> Tobacco Control, 49 Stat. 1240, 7 U. S. C. A. 515d; Freight Rate Adjustments, 52 Stat. 36, 7 U. S. C. A. 1291 (d); Crop Insurance, 52 Stat. 73, 7 U. S. C. A. 1507 (c) and (e).

<sup>8</sup> 49 Stat. 163, 16 U. S. C. A. 590.

<sup>9</sup> 52 Stat. 31, 32, 16 U. S. C. A. 590 (h) (b).

<sup>10</sup> 52 Stat. 31, 7 U. S. C. A. 1281 to 1407, inclusive.

<sup>11</sup> 52 Stat. 36, 37; 7 U. S. C. A. 1291 (d).

As codified the act contains also the following provision:

The provisions of section 590h (b) and section 590k of Title 16 [Soil Conservation], relating to the utilization of State, county, local committees, the extension service, and other approved agencies, and to recognition and encouragement of cooperative associations, shall apply in the administration of this act; and the Secretary shall, for such purposes, utilize the same local, county, and State committees as are utilized under sections 590g, 590h, 590i, and 590j–590q of Title 16.<sup>12</sup>

The Federal Crop Insurance Act <sup>13</sup> enacted in 1938 contains the following statement:

In carrying out the provisions of this chapter the Board may, in its discretion, utilize producer-owned and producer-controlled cooperative associations.<sup>14</sup>

### Statutes Providing for Research

The Appropriation Act for the Department of Agriculture for the fiscal year beginning July 1, 1913,<sup>15</sup> contained the following provision:

That the President of the United States shall appoint a commission composed of not more than seven persons who shall serve without compensation to cooperate with the American commission assembled under the auspices of the Southern Commercial Congress to investigate and study in European countries cooperative land-mortgage banks, cooperative rural credit unions, and similar organizations and institutions devoting their attention to the promotion of agriculture and the betterment of rural conditions, and for the purpose of its investigations the commission shall be authorized to incur and have paid upon the certificate of its chairman such expenses in the city of Washington and elsewhere for the payment of the salaries of employees, clerks, stenographers, assistants and such other necessary expenses as the commission may deem necessary: *Provided*, That the total expenses incurred for all purposes shall not exceed the sum of \$25,000, and the said commission shall submit a report to Congress as early as practicable, embodying the results of its investigations and such recommendations as it may see fit to make.

Acting under this authorization the American and United States Commission for the study of agricultural cooperation in Europe undertook an investigation in Europe in 1913, and its results are published in a 900-page report, which has been printed as a public document.<sup>16</sup>

The Appropriation Act just referred to contained also the following provision: <sup>17</sup>

To enable the Secretary of Agriculture to acquire and to diffuse among the people of the United States useful information on subjects connected with the marketing and distributing of farm products, and for the employment of persons and means necessary in the city of Washington and elsewhere, there is hereby appropriated the sum of \$50,000, of which sum \$10,000 shall be immediately available.

Pursuant to this authority, the Office of Markets <sup>18</sup> was organized, in which a project "Cooperative Purchasing and Marketing" was established in 1913. This project engaged in research and other work relative to agricultural cooperation which was continued by it and its successors, pursuant to authority contained in subsequent appropriation acts until the enactment of the Cooperative Marketing Act of 1926. The purposes of this act are disclosed by its title, which reads: <sup>19</sup>

<sup>12</sup> 52 Stat. 68, 7 U. S. C. A. 1388 (a).

<sup>13</sup> 52 Stat. 72, 7 U. S. C. A. 1501 to 1518, inclusive.

<sup>14</sup> 52 Stat. 73, 7 U. S. C. A. 1507 (e).

<sup>15</sup> 37 Stat. 828, 855.

<sup>16</sup> AGRICULTURAL COOPERATION AND RURAL CREDIT IN EUROPE. 63d Cong., 1st sess., S. Doc. 214, 3 pts. See also Elsworth, R. H., THE STORY OF FARMERS' COOPERATIVES. FCS Educ. Cir. 1, 31 pp., illus. 1954. See p. 14. Farmer Coop. Serv., U. S. D. A.

<sup>17</sup> 37 Stat. 854.

<sup>18</sup> Elsworth, R. H., THE STORY OF FARMERS' COOPERATIVES. FCS Educ. Cir. 1, 31 pp., illus., 1954. See p. 14. Farmer Coop. Serv., U. S. D. A.

<sup>19</sup> 44 Stat. 802, 7 U. S. C. A. 451.

An act to create a division of cooperative marketing in the Department of Agriculture; to provide for the acquisition and dissemination of information pertaining to cooperation; to promote the knowledge of cooperative principles and practices; to provide for calling advisers to counsel with the Secretary of Agriculture on cooperative activities; to authorize cooperative associations to acquire, interpret, and disseminate crop and market information, and for other purposes.

Under this act, the United States Department of Agriculture, through the Farmer Cooperative Service, is authorized:

1. To acquire, analyze, and disseminate economic statistical, and historical information, regarding the progress, organization and business methods of cooperatives in the United States and foreign countries.

2. To conduct studies of the economic, legal, financial, social, and other phases of cooperation, and publish the results thereof. Such studies shall include the analyses of the organization, operation, financial, and merchandising problems of cooperatives.

3. To make surveys and analyses if deemed advisable of the accounts and business practices of representative cooperatives upon their request; to report to the association so surveyed the results thereof; and with the consent of the association so surveyed to publish summaries of the results of such surveys, together with similar facts, for the guidance of associations and for the purpose of assisting associations and developing methods of business and market analysis.

4. To confer and advise with committees or groups of producers, if deemed advisable, that may be desirous of forming a cooperative and to make an economic survey and analysis of the facts surrounding the production and marketing of the agricultural product or products which the association, if formed, would handle or market.

5. To acquire from all available sources information concerning crop prospects, supply, demand, current receipts, exports, imports, and prices of the agricultural products handled or marketed by cooperatives, and to employ qualified commodity marketing specialists to summarize and analyze this information and disseminate the same among cooperatives and others.

6. To promote the knowledge of cooperative principles and practices and to cooperate, in promoting such knowledge, with educational and marketing agencies, cooperatives, and others.

7. To make such special studies, in the United States and foreign countries, and to acquire and disseminate such information and findings as may be useful in the development and practice of cooperation.

In accordance with an Executive order in 1929<sup>20</sup> the Cooperative Marketing Division was transferred from the Department of Agriculture to the Federal Farm Board, and in accordance with another Executive order executed in 1933<sup>21</sup> the Division became a part of the Farm Credit Administration. On December 4, 1953, it was transferred from Farm Credit Administration to the Secretary of Agriculture and established as the Farmer Cooperative Service of the United States Department of Agriculture.<sup>22</sup>

### **Statutes Involving Electric Projects**

The Tennessee Valley Authority Act of 1933 as amended<sup>23</sup> authorized the board of directors to cooperate "with farmers, landowners, and associa-

<sup>20</sup> Exec. Order 5200, dated and effective October 1, 1929.

<sup>21</sup> Exec. Order 6084 dated March 27, 1933, effective May 27, 1933.

<sup>22</sup> 67 Stat. 390, 394; 7 U. S. C. A. 452, Note; Secretary Memorandum No. 1320, Supplement No. 4, November 2, 1953.

<sup>23</sup> 48 Stat. 58, 49 Stat. 1076; 16 U. S. C. A. 831d (c).



tions of farmers or landowners, for the use of new forms of fertilizer or fertilizer practices \* \* \*.” The act as amended provides that States, counties, municipalities, and cooperative organizations of citizens or farmers shall be entitled to preference in the sale of surplus power, and in order to facilitate the disposition of surplus power the corporation is authorized to extend credit to such institutions for a period of not exceeding 5 years.

The acts authorizing the Bonneville project<sup>24</sup> and the Fort Peck project<sup>25</sup> also conferred on cooperatives certain preferences and priorities in the purchase of power.

At the time this is written,<sup>26</sup> it is believed that the most significant references to cooperatives are contained in the Federal statutes referred to herein. Of course, there are other Federal statutes which affect cooperatives as they do other business entities; such, for example, as the Federal Trade Commission Act,<sup>27</sup> the Perishable Agricultural Commodities Act,<sup>28</sup> the National Labor Relations Act,<sup>29</sup> and the Fair Labor Standards Act,<sup>30</sup> but cooperatives are not mentioned in these statutes.

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<sup>24</sup> 50 Stat. 731, 16 U. S. C. A. 832.

<sup>25</sup> 52 Stat. 403, 16 U. S. C. A. 833.

<sup>26</sup> 1956.

<sup>27</sup> 38 Stat. 717, 15 U. S. C. A. 41.

<sup>28</sup> 46 Stat. 531, 7 U. S. C. A. 499a.

<sup>29</sup> 49 Stat. 449, 29 U. S. C. A. 151; *National Labor Relations Board v. Grower-Shipper Vegetable Association*, 122 F. 2d 368.

<sup>30</sup> 52 Stat. 1060, 29 U. S. C. A. 201; *Redlands Foothill Groves v. Jacobs*, 30 F. Supp. 995.

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## Appendix

### Bingham Cooperative Marketing Act

[Based on Baldwin's 1936 revision of Carroll's Kentucky Statutes, annotated, 8th Ed.; with footnotes on later developments.]

§ 883f-1. *Declaration of policy.*—In order to promote, foster, and encourage the intelligent and orderly marketing of agricultural products through cooperation; and to eliminate speculation and waste; and to make the distribution of agricultural products between producer and consumer as direct as can be efficiently done; and to stabilize the marketing of agricultural products, this Act is passed. (1922, c. 1, p. 1, § 1.)<sup>1</sup>

§ 883f-2. *Definitions.*—As used in this act:

(a) The term "agricultural products" shall include horticultural, viticultural, forestry, dairy, live stock, poultry, bee, and any farm products.

(b) The term "member" shall include actual members of associations without capital stock and holders of common stock in associations organized with capital stock.

(c) The term "association" means any corporation organized under this act; and

(d) The term "person" shall include individuals, firms, partnerships, corporations and associations.

Associations organized hereunder shall be deemed "nonprofit," inasmuch as they are not organized to make profit for themselves, as such, or for their members, as such, but only for their members as producers.

(e) For the purpose of brevity and convenience this act may be indexed, referred to and cited as "The Bingham Cooperative Marketing act." (1922, c. 1, p. 1, § 2.)

§ 883f-3. *Who may organize.*—Twenty (20) or more persons, a majority of whom are residents of this state, engaged in the production of agricultural products, may form a nonprofit, cooperative association, with or without capital stock, under the provisions of this act. (1922, c. 1, p. 1, § 3.)

§ 883f-4. *Purposes.*—An association may be organized to engage in any activity in connection with the marketing or selling of the agricultural products of its members, or with the harvesting, preserving, drying, processing, canning, packing, grading, storing, handling, shipping or utilization thereof, or the manufacturing or marketing of the byproducts thereof; or in connection with the manufacturing, selling or supplying to its members of machinery, equipment or supplies; or in the financing of the above enumerated activities; or in any one or more of the activities specified herein. (1922, c. 1, p. 1, § 4.)

§ 883f-5. *Preliminary investigation.*—Every group of persons contemplating the organization of an association under this act is urged to communicate with the dean of the college of agriculture of the university of Kentucky, who will inform them whatever a survey of marketing conditions affecting the commodities proposed to be handled may indicate regarding probable success.

It is here recognized that agriculture is characterized by individual production in contrast to the group or factory system that characterizes other forms of industrial production; and that the ordinary form of corporate organization permits industrial groups to combine for the purpose of group production and the ensuing group marketing and that the public has an interest in permitting farmers to bring their industry to the high degree of efficiency and merchandising skill evidenced in the manufacturing industries; and that the public interest urgently needs to prevent the migration from the farm to the city in order to keep up farm production and to preserve the agricultural supply of the nation; and that the public interest demands that the farmer be encouraged to attain a superior and more direct system of marketing in the substitution of merchandising for the blind, unscientific and speculative selling of crops; and that for this purpose, the farmers should secure special guidance and instructive data from the dean of the college of agriculture of the university of Kentucky. (1922, c. 1, p. 1, § 5.)

<sup>1</sup> Repealed effective June 12, 1940. (1940, c. 191, sec. 1.)

§ 883f-6. *Powers*.—Each association incorporated under this act shall have the following powers: (a) To engage in any activity in connection with the marketing, selling, preserving, harvesting, drying, processing, manufacturing, canning, packing, grading, storing, handling or utilization of any agricultural products produced or delivered to it by its members, or the manufacturing or marketing of the byproducts thereof; or any activity in connection with the purchase, hiring, or use by its members of supplies, machinery or equipment; or in the financing of any such activities; or in any one or more of the activities specified in this section. And such association may also buy, sell and deal in the agricultural products of nonmembers to an amount not greater in value than such as are handled by it for its members. (b) To borrow money without limitation as to amount of corporate indebtedness or liability; and to make advances to members. (c) To act as the agent or representative of any member or members in any of the above mentioned activities. (d) To purchase or otherwise acquire; and to hold, own, and exercise all rights of ownership in; and to sell, transfer or pledge, or guarantee the payment of dividends or interest on, or the retirement or redemption of, shares of the capital stock or bonds of any corporation or association engaged in any related activity or in the warehousing or handling or marketing of any of the products handled by the association. (e) To establish reserves and to invest the funds thereof in bonds or in such other property as may be provided in the bylaws. (f) To buy, hold and exercise all privileges or ownership, over such real or personal property as may be necessary or convenient for the conduct and operation of any of the business of the association, or incidental thereto. (g) To do each and every thing necessary, suitable or proper for the accomplishment of any one of the purposes or the attainment of any one or more of the subjects herein enumerated; or conducive to or expedient for the interest or benefit of the association; or to contract accordingly; and in addition to exercise and possess all powers, rights and privileges necessary or incidental to the purposes for which the association is organized or to the activities in which it is engaged; and, in addition, any other rights, powers and privileges granted by the laws of this state to ordinary corporations, except such as are inconsistent with the express provisions of this act; and to do any such thing anywhere. (1934, c. 124, § 1; 1922, c. 1, p. 1, § 6. Eff. June 14, 1934.)

§ 883f-7. *Members*.—(a) Under the terms and conditions prescribed in the bylaws adopted by it, an association may admit as members, or issue common stock to, persons only engaged in the production of the agricultural products to be handled by or through the association, including the lessees and tenants of land used for the production of such products and any lessors and landlords who receive as rent all or part of the crop raised on the leased premises.

(b) If a member of a nonstock association be other than a natural person, such member may be represented by any individual, associate, officer or manager or member thereof, duly authorized in writing.

(c) One association organized hereunder may become a member or stockholder of any other association or associations organized hereunder. (1922, c. 1, p. 1, § 7.)

§ 883f-8. *Articles of incorporation*.—Each association formed under this act must prepare and file articles of incorporation, setting forth:

(a) The name of the association.

(b) The purposes for which it is formed.

(c) The place where its principal business will be transacted.

(d) The term for which it is to exist, not exceeding fifty (50) years.

(e) The number of directors thereof, which must be not less than five (5) and may be any number in excess thereof; the term of office of such directors; and the names and addresses of those who are to serve as incorporating directors for the first term, or until election and qualification of their successors.

(f) If organized without capital stock, whether the property rights and interest of each member shall be equal or unequal; and if unequal, the general rule or rules applicable to all members by which the property rights and interests, respectively, of each member may and shall be determined and fixed; and provision for the admission of new members who shall be entitled to share in the property of the association with the old members, in accordance with such general rule or rules. This provision or paragraph of the articles of incorporation shall not be altered, amended, or repealed except by the written consent or vote of three-fourths of the members.

(g) If organized with capital stock, the amount of such stock and the number of shares into which it is divided and the par value thereof.

The capital stock may be divided into preferred and common stock. If so divided, the articles of incorporation must contain a statement of the number of shares of stock to which preference is granted and the number of shares of stock



to which no preference is granted and the nature and definite extent of the preference and privileges granted to each.

The articles must be subscribed by the incorporators and acknowledged by one of them before an officer authorized by the law of this State to take and certify acknowledgments of deeds and conveyances; and shall be filed in accordance with the provisions of the general corporation law of this State; and when so filed the said articles of incorporation, or certified copies thereof shall be received in all the courts of this State and other places, as prima facie evidence of the facts contained therein and of the due incorporation of such association. A certified copy of the articles of incorporation shall also be filed with the dean of the college of agriculture of the university of Kentucky. (1922, c. 1, p. 1, § 8.)

§ 883f-9. *Amendments to articles of incorporation.*—The articles of incorporation may be altered or amended at any regular meeting or any special meeting called for that purpose. An amendment must first be approved by two-thirds of the directors and then adopted by a vote representing a majority of all the members of the association. Amendments to the articles of incorporation, when so adopted, shall be filed in accordance with the provisions of the general corporation law of this State. (1922, c. 1, p. 1, § 9.)

§ 883f-10. *Bylaws.*—Each association incorporated under this act must, within thirty (30) days after its incorporation, adopt for its government and management, a code of bylaws, not inconsistent with the powers granted by this act. A majority vote of the members or stockholders, or their written assent, is necessary to adopt such bylaws. Each association, under its bylaws, may provide for any or all of the following matters:

- (a) The time, place and manner of calling and conducting its meetings.
- (b) The number of stockholders or members constituting a quorum.
- (c) The right of members or stockholders to vote by proxy or by mail or both; and the conditions, manner, form, and effects of such votes.
- (d) The number of directors constituting a quorum.
- (e) The qualifications, compensation and duties and term of office of directors and officers; time of their election and the mode and manner of giving notice thereof.
- (f) Penalties for violations of the bylaws.
- (g) The amount of entrance, organization and membership fees, if any; the manner and method of collection of the same; and the purposes for which they may be used.
- (h) The amount which each member or stockholder shall be required to pay annually or from time to time, if at all, to carry on the business of the association; the charge, if any, to be paid by each member or stockholder for services rendered by the association to him and the time of payment and the manner of collection; and the marketing contract between the association and its members or stockholders which every member or stockholder may be required to sign.

(i) The number and qualification of members or stockholders of the association and the conditions precedent to membership or ownership of common stock; the method, time and manner of permitting members to withdraw or the holders of common stock to transfer their stock; the manner of assignment and transfer of the interest of members and of the shares of common stock; the conditions upon which and time when membership of any member shall cease; the automatic suspension of the rights of a member when he ceases to be eligible to membership in the association; and the mode, manner and effect of the expulsion of a member; the manner of determining the value of a member's interest and provision for its purchase by the association upon the death or withdrawal of a member or stockholder, or upon the expulsion of a member or forfeiture of his membership, or, at the option of the association, the purchase of a price fixed by conclusive appraisal by the board of directors. In case of the withdrawal or expulsion of a member, the board of directors shall equitably and conclusively appraise his property interests in the association and shall fix the amount thereof in money, which shall be paid to him within 1 year after such expulsion or withdrawal. (1922, c. 1, p. 1, § 10.)

§ 883f-11. *General and special meetings; how called.*—In its bylaws, each association shall provide for one or more regular meetings annually. The board of directors shall have the right to call a special meeting at any time; and ten percent of the members or stockholders may file a petition stating the specific business to be brought before the association and demand a special meeting at any time. Such meeting must thereupon be called by the directors. Notice of all meetings, together with a statement of the purposes thereof, shall be mailed to each member at least 10 days prior to the meeting; provided, however, that the bylaws may require instead that such notice may be given by publication in a newspaper of general circulation, published at the principal place of business of the association. (1922, c. 1, p. 1, § 11.)

§ 883f-12. *Directors; election.*—The affairs of the association shall be managed by a board of not less than five directors, elected by the members or stockholders from their own number. The bylaws may provide that the territory in which the association has members shall be divided into districts and that the directors shall be elected according to such districts, either directly or by district delegates elected by the members in that district. In such a case the bylaws shall specify the number of directors to be elected by each district, the manner and method of reapportioning the directors and of redistricting the territory covered by the association. The bylaws may provide that primary elections shall be held in each district to elect the directors apportioned to such districts and that the result of all such primary elections may be ratified by the next regular meeting of the association or may be considered final as to the association. The bylaws may provide that one or more directors may be appointed by any public official or commission or by the other directors selected by the members or their delegates. Such directors shall represent primarily the interest of the general public in such associations. The director or directors so appointed need not be members or stockholders of the association; but shall have the same powers and rights as other directors. Such directors shall not number more than one-fifth of the entire number of directors.

An association may provide a fair remuneration for the time actually spent by its officers and directors in its service and for the service of the members of its executive committee. No director, during the term of his office, shall be a party to a contract for profit with the association differing in any way from the business relations accorded regular members or holders of common stock of the association or others, or differing from terms generally current in that district.

The bylaws may provide for an executive committee and may allot to such committee all the functions and powers of the board of directors, subject to the general direction and control of the board.

When a vacancy on the board of directors occurs other than by expiration of term, the remaining members of the board, by a majority vote, shall fill the vacancy, unless the bylaws provide for an election of directors by district. In such a case the board of directors shall immediately call a special meeting of the members or stockholders in that district to fill the vacancy. (1922, c. 1, p. 1, § 12.)

§ 883f-13. *Election of officers.*—The directors shall elect from their number a president and one or more vice presidents. They shall also elect a secretary and a treasurer, who need not be directors or members of the association; and they may combine the two latter offices and designate the combined office as secretary-treasurer; or unite both functions and titles in one person. The treasurer may be a bank or any depository, and as such, shall not be considered as an officer, but as a function, of the board of directors. In such case, the secretary shall perform the usual accounting duties of the treasurer, excepting that the funds shall be deposited only as and where authorized by the board of directors. (1922, c. 1, p. 1, § 13.)

§ 883f-14. *Stock membership certificate; when issued; voting; liability; limitations on transfer and ownership.*—When a member of an association established without capital stock has paid his membership fee in full, he shall receive a certificate of membership.

No association shall issue stock to a member until it has been fully paid for. The promissory notes of the members may be accepted by the association as full or partial payment. The association shall hold the stock as security for the payment of the note; but such retention as security shall not affect the member's right to vote.

No member shall be liable for the debts of the association to an amount exceeding the sum remaining unpaid on his membership fee or his subscription to the capital stock, including any unpaid balance on any promissory notes given in payment thereof.

No stockholder of a cooperative association shall own more than one-twentieth ( $\frac{1}{20}$ ) of the common stock of the association; and an association, in its bylaws, may limit the amount of common stock which one member may own to any amount less than one-twentieth ( $\frac{1}{20}$ ) of the common stock.

No member or stockholder shall be entitled to more than one vote, regardless of the number of shares of common stock owned by him.

Any association organized with stock under this act may issue preferred stock with or without the right to vote. Such stock may be redeemable or retirable by the association on such terms and conditions as may be provided for by the articles of incorporation and printed on the face of the certificate.

The bylaws shall prohibit the transfer of the common stock of the association to persons not engaged in the production of the agricultural products handled by the

association; and such restrictions must be printed upon every certificate of stock subject thereto.

The association may, at any time, as specified in the bylaws, except when the debts of the association exceed fifty percent (50%) of the assets thereof, buy in or purchase its common stock at the book value thereof, as conclusively determined by the board of directors, and pay for it in cash within one (1) year thereafter. (1922, c. 1, p. 1, § 14.)

§ 883f-15. *Removal of officer or director.*—Any member may bring charges against an officer or director by filing them in writing with the secretary of the association, together with a petition signed by 5 percent of the members, requesting the removal of the officer or director in question. The removal shall be voted upon at the next regular or special meeting of the association and, by a vote of a majority of the members, the association may remove the officer or director and fill the vacancy. The director or officer, against whom such charges have been brought, shall be informed in writing of the charges previous to the meeting and shall have an opportunity at the meeting to be heard in person or by counsel and to present witnesses; and the person or persons bringing the charges against him shall have the same opportunity.

In case the bylaws provide for election of directors by districts with primary elections in each district, then the petition for removal of a director must be signed by 20 percent of the members residing in the district from which he was elected. The board of directors must call a special meeting of the members residing in that district to consider the removal of the director; and by a vote of the majority of the members of that district, the director in question shall be removed from office. (1922, c. 1, p. 1, § 15.)

§ 883f-16. *Referendum.*—Upon demand of one-third of the entire board of directors, any matter that has been approved or passed by the board must be referred to the entire membership or the stockholders for decision at the next special or regular meeting; provided, however, that a special meeting may be called for the purpose. (1922, c. 1, p. 1, § 16.)

§ 883f-17. *Marketing contract.*—The association and its members may make and execute marketing contracts, requiring the members to sell, for any period of time, not over 10 years, all or any specified part of their agricultural products or specified commodities exclusively to or through the association, or any facilities to be created by the association. If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery; or at any other specified time if expressly and definitely agreed in the said contract. The contract may provide that the association may sell or resell the products delivered by its members, with or without taking title thereto; and pay over to its members the resale price, after deducting all necessary selling, overhead and other costs and expenses, including interest on preferred stock, not exceeding eight (8) percent per annum, and reserves for retiring the stock, if any; and other proper reserves; and interest not exceeding eight (8) percent per annum upon common stock. (1922, c. 1, p. 1, § 17.)

§ 883f-18. *Remedies for breach of contract.*—(a) The bylaws or the marketing contract may fix, as liquidated damages, specific sums to be paid by the member or stockholder to the association upon the breach by him of any provision of the marketing contract regarding the sale or delivery or withholding of products; and may further provide that the member will pay all costs, premiums for bonds, expenses and fees, in case any action is brought upon the contract by the association; and any such provisions shall be valid and enforceable in the courts of this state; and such clauses providing for liquidated damages shall be enforceable as such and shall not be regarded as penalties.

(b) In the event of any such breach or threatened breach of such marketing contract by a member, the association shall be entitled to an injunction to prevent the further breach of the contract and to a decree of specific performance thereof. Pending the adjudication of such an action and upon filing a verified complaint showing the breach or threatened breach, and upon filing a sufficient bond, the association shall be entitled to a temporary restraining order and preliminary injunction against the member.

(c) In any action upon such marketing agreements, it shall be conclusively presumed that a landowner or landlord or lessor is able to control the delivery of products produced on his land by tenants or others, whose tenancy or possession or work on such land or the terms of whose tenancy or possession or labor thereon were created or changed after execution by the landowner or landlord or lessor, of such a marketing agreement; and in such actions, the foregoing remedies for nondelivery or breach shall lie and be enforceable against such landowner, landlord or lessor. (1922, c. 1, p. 1, § 18.)



§ 883f-19. *Purchasing business of other associations, persons, firms or corporations; payment; stock issued.*—Whenever an association, organized hereunder with preferred capital stock, shall purchase the stock or any property, or any interest in any property of any person, firm or corporation or association, it may discharge the obligations so incurred, wholly or in part, by exchanging for the acquired interest, shares of its preferred capital stock to an amount which at par value would equal the fair market value of the stock or interest so purchased, as determined by the board of directors. In that case the transfer to the association of the stock or interest purchased shall be equivalent to payment in cash for the shares of stock issued. (1922, c. 1, p. 1, § 19.)

§ 883f-20. *Annual reports.*—Each association formed under this act shall prepare and make out an annual report on forms to be furnished by the dean of the college of agriculture of the university of Kentucky, containing the name of the association; its principal place of business; and a general statement of its business operations during the fiscal year, showing the amount of capital stock paid up and the number of stockholders of a stock association or the number of members and amount of membership fees received, if a non-stock association; the total expenses of operations; the amount of its indebtedness or liabilities, and its balance sheet. (1922, c. 1, p. 1, § 20.)

§ 883f-21. *Conflicting laws not to apply.*—Any provisions of law which are in conflict with this act shall not be construed as applying to the associations herein provided for. Any exemptions under any and all existing laws applying to agricultural products in the possession or under the control of the individual producer, shall apply similarly and completely to such products delivered by its farmer members, in the possession or under the control of the association. (1922, c. 1, p. 1, § 21.)

§ 883f-22. *Limitation of the use of term "cooperative."*—No person, firm, corporation or association, hereafter organized or doing business in this State, shall be entitled to use the word "cooperative" as part of its corporate or other business name or title for producers' cooperative marketing activities, unless it has complied with the provisions of this act.

Any person, firm, corporation, or association now organized and existing, or doing a producers' cooperative marketing business in this State and embodying the word "cooperative" as part of its corporate or other business name or title, and which is not organized in compliance with the provisions of this act, must, within 6 months from the date at which this act goes into effect, eliminate the word "cooperative" from its said corporate or other business name or title. (1922, c. 1, p. 1, § 22.)

§ 883f-23. *Interest in other corporations or associations.*—An association may organize, form, operate, own, control, have an interest in, own stock of, or be a member of any other corporation or corporations, with or without capital stock, and engaged in preserving, drying, processing, canning, packing, storing, handling, shipping, utilizing, manufacturing, marketing or selling of the agricultural products handled by the association, or the byproducts thereof.

If such corporations are warehousing corporations, they may issue legal warehouse receipts to the association against the commodities delivered by it, or to any other person and such legal warehouse receipts shall be considered as adequate collateral to the extent of the usual and current value of the commodity represented thereby. In case such warehouse is licensed or licensed and bonded under the laws of this state or the United States, its warehouse receipt delivered to the association on commodities of the association or its members, or delivered by the association or its members, shall not be challenged or discriminated against because of ownership or control, wholly or in part, by the association. (1922, c. 1, p. 1, § 23.)

§ 883f-24. *Contracts and agreements with other associations.*—Any association may, upon resolution adopted by its board of directors, enter into all necessary and proper contracts and agreements and make all necessary and proper stipulations, agreements and contracts and arrangements with any other cooperative corporation, association or associations, formed in this or in any other state, for the cooperative and more economical carrying on of its business or any part or parts thereof. Any two or more associations may, by agreement between them, unite in employing and using or may separately employ and use the same personnel, methods, means and agencies for carrying on and conducting their respective businesses. (1922, c. 1, p. 1, § 24.)

§ 883f-25. *Associations heretofore organized may adopt the provisions of this act.*—Any corporation or association, organized under previously existing statutes, may, by a majority vote of its stockholders or members, be brought under the provisions of this act by limiting its membership and adopting the other restrictions as provided herein. It shall make out in duplicate a statement signed and sworn

to by its directors to the effect that the corporation or association has, by a majority vote of the stockholders or members, decided to accept the benefits and be bound by the provisions of this act and has authorized all changes accordingly. Articles of incorporation shall be filed as required in K. S. § 883f-8, except that they shall be signed by the members of the then board of directors. The filing fee shall be the same as for filing an amendment to articles of incorporation.

(a) Where any association may be incorporated under this act, all contracts heretofore made by or on behalf of same by the promoters thereof in anticipation of such association becoming incorporated under the laws of this State, whether such contracts be made by or in the name of some corporation organized elsewhere and when same would have been valid if entered into subsequent to the passage of this act, are hereby validated as if made after the passage of this act. (1922, c. 1, p. 1, § 25.)

§ 883f-26. *Misdemeanor to induce breach of marketing contract of cooperative association; spreading false reports about the finances or management thereof.*—Any person or persons or any corporation whose officers or employees knowingly induce or attempt to induce any member or stockholder of an association organized hereunder to breach his marketing contract with the association, or who maliciously and knowingly spreads false reports about the finances or management thereof, shall be guilty of a misdemeanor and be subject to a fine of not less than one hundred dollars (\$100.00) and not more than one thousand dollars (\$1,000.00) for each such offense; and shall be liable to the association aggrieved in a civil suit in the penal sum of five hundred dollars (\$500.00) for each such offense. (1922, c. 1, p. 1, § 26.)

§ 883f-27. *Warehousemen liable for damages for encouraging or permitting delivery of products in violation of marketing agreements.*—Any person, firm or corporation conducting a warehouse within the State of Kentucky who solicits or persuades or permits any member of any association organized hereunder to breach his marketing contract with the association by accepting or receiving such member's products for sale or for auction or for display for sale, contrary to the terms of any marketing agreement of which said person or any member of the said firm or any active officer or manager of the said corporation has knowledge or notice, shall be liable to the association aggrieved in a civil suit in the penal sum of five hundred dollars (\$500.00) for each such offense; and such association shall be entitled to an injunction against such warehouseman to prevent further breaches and a multiplicity of actions thereon. In addition, said warehouseman shall pay to the association a reasonable attorney's fee and all costs involved in any such litigation or proceedings at law.

This section is enacted in order to prevent a recurrence or outbreak of violence and to give marketing associations an adequate remedy in the courts against those who encourage violations of cooperative contracts. (1922, c. 1, p. 1, § 27.)

§ 883f-28. *Associations are not in restraint of trade.*—Any association organized hereunder shall be deemed not to be a conspiracy nor a combination in restraint of trade nor an illegal monopoly; nor an attempt to lessen competition or to fix prices arbitrarily or to create a combination or pool in violation of any law of this State; and the marketing contracts and agreements between the association and its members and any agreements authorized in this act shall be considered not to be illegal nor in restraint of trade nor contrary to the provisions of any statute enacted against pooling or combinations. (1922, c. 1, p. 1, § 28.)

§ 883f-29. *Constitutionality.*—If any section of this act shall be declared unconstitutional for any reason, the remainder of this act shall not be affected thereby. (1922, c. 1, p. 1, § 29.)<sup>2</sup>

§ 883f-30. *Application of general corporation laws.*—The provisions of the general corporation laws of this State and all powers and rights thereunder, shall apply to the associations organized hereunder, except where such provisions are in conflict with or inconsistent with the express provisions of this act. (1922, c. 1, p. 1, § 30.)<sup>3</sup>

§ 883f-31. *Taxation.*—The shares of corporations organized under this act shall be taxable as against the owner thereof as of the period of assessment of other personal property for taxation in this State.

Such shares will represent in the aggregate all the property held or owned by such corporation, and when taxed as against the individual owner all of the property in the name of said association will thereby be taxed.

Under existing law crops grown in the year of assessment are exempt from tax whilst owned by the producer. So much of the value of each share of said stock

<sup>2</sup> Repealed effective June 12, 1940. (1940, c. 191, sec. 1.)

<sup>3</sup> Omitted from Kentucky Revised Statutes 1953 as covered by general law relating to private corporations. See KRS 271.015.

as may represent the owner's proportion of crops grown by him and delivered to the association as herein provided, shall be exempt from taxation, inasmuch as it is the same thing exempted now by the constitution and laws of this State to such grower. (1922, c. 1, p. 1, § 31.)<sup>4</sup>

§ 883f-32. *Filing fees.*—For filing articles of incorporation, an association organized hereunder shall pay ten dollars (\$10.00); and for filing an amendment to the articles, two and 50/100 dollars (\$2.50). (1922, c. 1, p. 1, § 32.)

§ 883f-33. *Emergency clause.*—Whereas, the agricultural interests of the State are of the utmost importance to the people of Kentucky; and

Whereas, a demoralized condition of the farming interests of the State exists, injuriously affecting all other business; and

Whereas, the highest interests of the State generally demand immediate relief; and

Whereas, this act is designed and intended to afford such relief,

Therefore, an emergency is declared to exist and this act shall become effective immediately upon its passage and approval as required by law. (1922, c. 1, p. 1, § 33.)<sup>5</sup>

§ 883f-34. *Foreign marketing association may use word "cooperative" in name.*—That any cooperative marketing association organized in any State other than Kentucky having substantially the same purposes, restrictions and limitations as provided by the Bingham Cooperative Marketing act may use the word "cooperative" as part of its corporate or other business name or title for producers' cooperative marketing activities; and any such organization shall be deemed not to be a conspiracy, nor a combination in restraint of trade nor an illegal monopoly; nor an attempt to lessen competition or to fix prices arbitrarily or to create a combination or pool in violation of any law of this State; and its marketing contracts and agreements shall be considered not to be illegal nor in restraint of trade nor contrary to the provisions of any statute enacted against pooling or combinations. (March 24, 1922, c. 109, p. 285, § 1.)

§ 883f-35. *Effective date.*—This act shall take effect and be in full force and effect from and after its passage. (March 24, 1922, c. 109, p. 285, § 2.)<sup>6</sup>

§ 883f-36. *Association to furnish information as to members and contracts.*—Upon application in writing by registered mail to any agricultural cooperative marketing association doing business under the laws of this commonwealth by any landowner, lessor or lessee of land on which any agricultural crops marketed by such association are being raised or are to be raised, asking for information as to whether a certain person or persons are members of such association, or have signed its marketing agreement or asking for information as to the terms of said contract, said association shall within 5 days after receipt of said request furnish said information in writing to the person or persons inquiring at the address given in the application. (March —, 1924, c. 1, p. 1, § 1.)

§ 883f-37. *Form of application.*—Such application shall give the full name of the person or persons concerning whom the information is requested and their post office addresses, and shall contain a return address of the person or persons to whom the information is to be sent. (March —, 1924, c. 1, p. 1, § 2.)

§ 883f-38. *Effect of failure to furnish information.*—Unless such information as above requested shall be furnished by said association, in any litigation which may arise between such association and the person or persons inquiring, it shall be presumed, in the absence of evidence to the contrary, that the person requesting said information was without notice that the person inquired about was a member of such association or had signed such marketing contract, or that the person inquiring knew the terms of the contract. (March —, 1924, c. 1, p. 1, § 3.)

§ 883f-39. *Effect of failure to request information.*—Unless such landlord, lessor or lessee shall have made the above inquiry and waited until the expiration of the time above set forth or until the receipt of answer thereto, in any litigation arising with such cooperative association, it shall be conclusively presumed that such person has notice of the contract or membership obligations actually existing between the association and its member or obligor. (March —, 1924, c. 1, p. 1, § 4.)

§ 883f-40. *Mortgage upon growing crops.*—That growers of agricultural products who have signed contracts with cooperative marketing associations, authorized by the Bingham Cooperative Marketing act, be, and they are hereby permitted to place crop mortgages upon crops in esse; but said crop mortgages shall not defeat the right of any association organized under the cooperative act to take delivery of any crop covered by a marketing contract. Any grower executing such a crop mortgage

<sup>4</sup> Pronounced unconstitutional in *Burley Tobacco Growers Coop. Association v. City of Carrollton*, 208 Ky. 270, 270 S. W. 749.

<sup>5</sup> Repealed effective June 12, 1940. (1940, c. 191, sec. 1.)



may make an assignment to the mortgagee of the grower's interest in the proceeds of such crop, subject to the provision of said marketing agreement, which assignment must be accepted by any association organized under said act. (March 29, 1924, c. 7, p. 9, § 1.)

§ 883f-41. *Foreclosure, attachment, etc.*—In the event of foreclosure, attachment or proceeding in court concerning any crop covered by such marketing agreement and mortgage, it shall be the duty of the court to direct that the crop shall be delivered to and sold by the said marketing association according to the terms of the contract and the proceeds derived therefrom so far as may be necessary to satisfy the judgment in the case shall be paid as directed by the judgment of the court. (March 29, 1924, c. 7, p. 9, § 2.)

## Suggested Organization Forms

**S**UGGESTED organization forms for agricultural associations of producers appear on the succeeding pages. The articles of incorporation and the bylaws provide for the organization of an association without capital stock. However, alternate paragraphs or provisions have been provided for use where the association is organized on a capital stock basis. These are indented in brackets or appear in the footnotes.

The fundamental cooperative principles discussed in the text, such as democratic control, the revolving-fund plan of financing, adequate reserves, and equitable distribution of earnings, are reflected in the forms.

Since these forms are general in character, the services of an attorney are required for adapting them to suit the needs of a particular association; and they should be checked, altered, and modified to meet the local needs and legal requirements of the State in which the association is to be incorporated. The forms should also be modified so as to best serve the business needs and methods of operation of the association.

While the forms have been prepared primarily for use in forming agricultural marketing associations of producers, they may be adapted for use in forming an association that is exclusively engaged in handling supplies. Ordinarily, such an association would not use a marketing agreement which would bind its members to patronize the association; revolving funds would be obtained by including in sales prices margins for the purpose of accumulating such funds, rather than by making deductions from sales proceeds; and certain other changes should be made.

## Organization Agreement

The undersigned, a producer of agricultural products, hereinafter referred to as "Producer," together with other signers of agreements similar hereto, for the purpose of engaging in-----

-----  
(In this space broadly state purposes for which association is to be organized)  
propose to organize a cooperative association without<sup>6</sup> capital stock under the laws of the State of -----, as hereinafter provided, and in consideration of the premises, hereby agrees for himself and for the express benefit of and for the association to be organized, as follows:

1. (a) The association shall be organized with suitable articles of incorporation and bylaws as determined by an organization committee consisting of the following persons (*State names and addresses of committee members*):

(b) This committee may, in the discretion of a majority thereof, increase its membership, fill any vacancy therein, and appoint any committees deemed necessary to conduct the details of its affairs. The committee, or any committee designated by it, may prescribe an organization fee to be paid by each person signing an organization agreement similar hereto and may incur necessary obligations, make necessary

<sup>6</sup> If association is to be formed with capital stock, "without" should be changed to "with."

expenditures, and take any such action as may, in its discretion, be deemed advisable to further the organization of the association.

2. The bylaws of the association shall provide, among other things, that

(Here enumerate the chief provisions which it is proposed shall be contained in the bylaws)

3. If, on or before \_\_\_\_\_, 19\_\_\_\_, the organization committee is of the opinion that sufficient sign-up has been obtained to enable the association to operate efficiently, the committee shall, by notice to be published in one or more newspapers of general circulation in the area in which those who sign agreements like this one reside, specify a date and place for a meeting of those who sign such agreements to enable those attending such meeting conclusively to determine, by majority vote, if a sufficient sign-up has been obtained to justify the formation and operation of the association, and to consider such other business as may be deemed expedient. Notice of the action there taken shall be published in one or more newspapers of general circulation in the area.

4. The organization committee shall keep full, true, and detailed accounts of all receipts and of all expenditures of every kind and shall have such accounts audited and render a written report thereof to the board of directors of the association when organized, and shall thereupon turn over to the association any balance remaining in its hands free of obligation. If the association is not so organized, such unexpended balance shall be prorated among those who contributed thereto.

5. Producer hereby subscribes for \_\_\_\_\_ revolving-fund certificates, each of the face value of \$\_\_\_\_\_, and agrees to pay therefor as follows:

If association is to be formed with capital stock, the following may be substituted for paragraph 5:

"Producer agrees to purchase and does hereby subscribe for one share of voting common stock of the association, par value \$\_\_\_\_\_, payable on demand following the acceptance hereof, and \_\_\_\_\_ shares of nonvoting preferred stock of the association, par value \$\_\_\_\_\_ each, and agrees to pay for same as follows:

\$\_\_\_\_\_ cash on demand following the incorporation of the association.

\$\_\_\_\_\_ on or before \_\_\_\_\_, 19\_\_\_\_.

\$\_\_\_\_\_ on or before \_\_\_\_\_, 19\_\_\_\_.

It is understood that certificates for such preferred stock shall not be issued and that no dividends shall be paid thereon until such shares have been paid in full. Producer hereby authorizes and directs the association to apply any and all dividends or distributions accruing to him during any year to the payment of any or all installments due or which may be due on such stock subscriptions for that year or for any prior year."

6. Producer applies for membership in the association when organized and expressly agrees that signature to the marketing agreement shall be deemed to all intents and purposes the same as signature to this organization agreement, all of which shall be irrevocable, except as provided in section 3 of this organization agreement and section 12 of the marketing agreement or the bylaws of the association, and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as for their own general benefit.

If an association is formed without capital stock and is not to use a marketing agreement, the following may be substituted for paragraph 6:

"Producer applies for membership in the association when organized and expressly agrees that signature hereto shall be irrevocable, except as provided in section 3 hereof or in the bylaws of the association, and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as for their own general benefit."

If association is to be formed with capital stock and is to use a marketing agreement, the following may be substituted for paragraph 6:

"Producer hereby agrees that his signature to the marketing agreement shall be deemed to all intents and purposes the same as his signature to this organization agreement, all of which shall be irrevocable except as provided in section 3 of this organization agreement and section 12 of the marketing agreement or the bylaws of the association and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as their own general benefit."

If an association is to be formed with capital stock and is not to use a marketing agreement, the following paragraph may be substituted for paragraph 6:

"Producer hereby agrees that his signature hereto shall be irrevocable, except as provided in section 3 hereof or in the bylaws of the association, and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as their own general benefit."

7. Acceptance hereof shall be deemed conclusive upon the mailing, by the association, of a notice to that effect to Producer at his address noted below, and such mailing and notice shall be conclusively established by the affidavit of the secretary of the association.

8. Subject to the terms hereof, Producer agrees to be bound by the terms of the following marketing agreement, which, on the acceptance hereof by the association, may be used separate from this organization agreement.

In those States which provide for the filing of record of marketing agreements, if desired, the following should be added at the end of the last sentence above: "and, upon demand of the Association when organized, to execute an agreement in like form and to acknowledge the same, if required, so as to entitle it to be filed of record."

This paragraph and other provisions herein relative to marketing agreements should be included only in the case of marketing associations and if no marketing agreement is used provision should be made for dating and for the signature and address of the Producer following paragraph 7.

## Marketing Agreement

This agreement between the \_\_\_\_\_ Association, hereinafter called the "Association" and the undersigned, hereinafter called the "Producer"

Witnesseth:

(1) The Association buys and the Producer sells to the Association all \_\_\_\_\_,

hereinafter referred to as "products," except those which the Producer reserves for his own personal use, but not for sale, produced by or for him or acquired by him as landlord or lessor and the Producer agrees to deliver all such products at such place or places as the Association may direct. This agreement is intended by the parties to pass an absolute title to all such products as soon as they have a potential existence but such products shall be at the risk of the Producer until delivery. The Association is authorized to exercise any powers conferred upon it hereunder through any central agency of which this and any other similar associations are or may become members.

(2) The Association agrees to make such advances to the Producer on such products delivered hereunder as in the discretion of its board of directors may be justified by marketing conditions.

(3) The Association agrees to sell, either in the natural or processed state, such products, together with the products delivered by other producers, and to pay over ratably the net amount received therefrom as payment in full to the Producer, after making deductions to cover (a) advances, interest upon advances, interest or dividends on capital, the cost of picking, gathering, harvesting, receiving, assembling, transporting, handling, grading, packing, inspecting, processing, financing, advertising, storing, insuring, selling, and marketing such products or products derived therefrom or both; (b) organization, operating and maintenance expenses and for capital in a central agency; (c) revolving-fund retains for the purpose of building up such an amount of capital as may be deemed necessary by its board of directors from time to time and for revolving such capital in the manner that may be provided in the bylaws

<sup>7</sup> Insert in this and corresponding blank spaces the agricultural product or products to be handled.



of the Association of not to exceed — percent of the gross sale price<sup>8</sup> of such products or products derived therefrom or both. The deductions made for capital purposes and for revolving such capital from time to time shall be evidenced by certificates of preferred stock in the Association.<sup>9</sup> The Association, within the discretion of its board of directors, is authorized to establish, from time to time, daily, weekly, monthly, or seasonal pools of the agricultural products marketed by it of the same variety, grade, and quality, and all producers having such products in the particular pool shall share ratably in the net amount received therefrom.

(4) All products shall be delivered by the Producer at the earliest reasonable time after harvesting at such places as the Association may direct, and with such identification at the Producer's expense as may be prescribed by the Association.

(5) Any loss that the Association may suffer on account of inferior or damaged condition of products at delivery shall be charged against the Producer, individually.

(6) The Producer further agrees that the Association or the central marketing agency, individually or jointly, shall have the power to borrow money for any purpose of the Association or the central marketing agency on the security of the products delivered to the Association, the products derived therefrom, or on any evidence of such products or byproducts or cash or accounts arising from the sale thereof; and to give a lien, either legal or equitable, thereon, as the absolute owner thereof; and the Association or the central marketing agency may grade, pool or commingle such product or products derived therefrom or any part thereof with other products of like grade and variety; and shall exercise all other rights of ownership without limitation.

(7) Inasmuch as the remedy at law would be inadequate and inasmuch as it would be impracticable and extremely difficult to determine the actual damage resulting to the Association should the Producer fail to deliver the products covered hereby, regardless of the cause of such failure, the Producer hereby agrees to pay to the Association for all products delivered or disposed of, by or for him, other than in accordance with the terms hereof, the sum of — cents per — on all products, as liquidated damages for the breach of this agreement; all parties agreeing that this agreement is one of a series dependent for its true value upon the adherence of each and all of the contracting parties to each and all of such agreements, but the cancellation of any other similar contract or the failure of any of the parties thereto to comply therewith shall not affect the validity of this contract.

(8) If the Association brings any action whatsoever by reason of a breach or threatened breach hereof, the Producer shall pay all costs of court, costs for bonds and otherwise, expenses of travel and all expenses arising out of or caused by the litigation, and reasonable attorney fees expended or incurred by it in such proceedings and all such costs and expenses shall be included in the judgment.

(9) It is agreed that the articles of incorporation and the bylaws, now or hereafter in effect, and this agreement constitute the entire agreement between the Association and the Producer.

(10) The Association may enter into agreements with other producers differing in terms from those contained herein but consistent with the bylaws of the Association without invalidating this agreement, provided that the Producer at his request may sign a similar agreement as a substitute for this agreement. By signing this agreement the Producer applies for membership in the Association and the signing hereof by the Association shall constitute an acceptance thereof.<sup>10</sup>

(11) The Association or the central agency shall establish or adopt standards for such products and shall make rules and regulations governing the handling and shipping thereof and shall provide inspectors or graders to grade the products; and the Producer agrees to be bound by such grading and to observe such rules and regulations. The Association or said central agency shall provide for the inspection of all products delivered hereunder, and if any such products are not in proper condition for sale they shall be prepared for sale at the expense of the Producer.

(12) After this agreement shall have been in effect 2 years from the date of its acceptance by the Association, either party hereto may terminate it in any year on the last day of the anniversary month in which this agreement was so accepted by notifying the other party in writing of this intention, such notice to be given between the first and fifteenth of the month immediately prior to the effective date of termination. If neither of the parties hereto terminates this agreement in any year, as aforesaid, it is hereby mutually agreed that this shall

<sup>8</sup> This may also read "----- cents per unit (i. e., bushel, carton)."

<sup>9</sup> In case an association is to be formed without capital stock, or if deemed desirable for any other reason, such deductions may be evidenced by revolving-fund certificates.

<sup>10</sup> If the Association is to be formed with capital stock, this sentence should be omitted.

constitute conclusive evidence that the parties hereto have renewed this agreement for another year.

(13) If there is a lien on any of the products delivered hereunder, the Producer authorizes the Association or central agency to pay the holder of said lien from the proceeds derived from the sale of such products before any payment is made to the Producer hereunder.

(14) The parties agree that there are no oral or other conditions, promises, covenants, representations or inducements in addition to or at variance with any of the terms hereof; and that this agreement represents the voluntary and clear understanding of both partners fully and completely.

Read, considered, and signed at \_\_\_\_\_ this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

Producer's signature \_\_\_\_\_ (Do not sign without reading) \_\_\_\_\_ (Print Producer's name here)

Address \_\_\_\_\_ (R. F. D. or Street No.) \_\_\_\_\_ (Town)

County \_\_\_\_\_ State \_\_\_\_\_

Accepted this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

By \_\_\_\_\_ Association.

Its \_\_\_\_\_

(Add acknowledgment if marketing agreement is to be filed of record)

### Articles of Incorporation<sup>11</sup>

of \_\_\_\_\_<sup>12</sup> Association

We, the undersigned, all of whom are residents and citizens of the State of \_\_\_\_\_, engaged in the production of agricultural products, do hereby voluntarily associate ourselves together for the purpose of forming a cooperative association, without<sup>13</sup> capital stock, under the provisions of the \_\_\_\_\_ Cooperative Marketing Act of the State of \_\_\_\_\_

### Article I—Name

The name of the association shall be the \_\_\_\_\_ Association.

### Article II—Purposes

The association is formed for the following purposes:<sup>14</sup>

To market for its members and other producers any and all agricultural products or any products derived therefrom; to engage in any activity in connection with the picking, gathering, harvesting, receiving, assembling, handling, grading, standardizing, packing, preserving, drying, processing, transporting, storing, financing, advertising, selling, marketing, or distributing of any such agricultural products or any products derived therefrom; to purchase for its members and other patrons farm supplies and equipment; to manufacture, process, sell, store, handle, ship, distribute, furnish, supply, and procure any and all such farm supplies and equipment; and to exercise all such powers in any capacity and on any cooperative basis that may be agreed upon.

### Article III—Powers; Limitations<sup>15</sup>

SECTION 1. *Powers.* This association shall have the following powers:

(a) To borrow money without limitation<sup>16</sup> as to amount or corporate indebtedness or liability; to give a lien on any of its property as security therefor in any manner

<sup>11</sup> The articles of incorporation should be carefully checked against the State statute and should meet its requirements and be consistent therewith.

<sup>12</sup> Wherever required, the word "cooperative" should appear in the name of the association. If the association plans to operate in more than one State, see discussion under "Name of Association," *supra*.

<sup>13</sup> If the association is to be formed with capital stock, this word should be "with."

<sup>14</sup> This article should be carefully modified in a manner consistent with the State statute to state the exact purposes for which a particular association is formed.

<sup>15</sup> In this as in other organization matters the statute under which an association is being incorporated should be consulted.

<sup>16</sup> In some States, the statutes require that the maximum indebtedness which may be incurred by a corporation be stated in its articles of incorporation.

permitted by law; and to make advance payments and advances to members and other producers.

(b) To act as the agent or representative of any patron or patrons in any of the activities mentioned in Article II hereof.

(c) To buy, lease, hold, and exercise all privileges of ownership, over such real or personal property as may be necessary or convenient for the conduct and operation of the business of the association, or incidental thereto.

(d) To draw, make, accept, indorse, guarantee, execute, and issue promissory notes, bills of exchange, drafts, warrants, certificates, and all kinds of obligations and negotiable or transferable instruments for any purpose that is deemed to further the objects for which this association is formed and to give a lien on any of its property as security therefor.

(e) To acquire, own, and develop any interest in patents, trademarks, and copyrights connected with or incidental to the business of the association.

(f) To cooperate with other similar associations in creating central, regional, or national cooperative agencies, for any of the purposes for which this association is formed, and to become a member or stockholder of such agencies as now are or hereafter may be in existence.

(g) To have and exercise, in addition to the foregoing, all powers, privileges, and rights conferred on ordinary corporations and cooperative marketing associations by the laws of this State and all powers and rights incidental or conducive to carrying out the purposes for which this association is formed, except such as are inconsistent with the express provisions of the act under which this association is incorporated, and to do any such thing anywhere; and the enumeration of the foregoing powers shall not be held to limit or restrict in any manner the general powers which may by law be possessed by this association, all of which are hereby expressly claimed.

**SECTION 2. Limitations.<sup>17</sup>** This association shall not market the products of nonmembers in an amount the value of which exceeds the value of the products marketed for members. It shall not purchase supplies and equipment for nonmembers in an amount the value of which exceeds the value of the supplies and equipment purchased for members. It shall not purchase supplies and equipment for persons who are neither members nor producers of agricultural products in an amount the value of which exceeds fifteen percent (15%) of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the limitations imposed by this section.

## **Article IV—Place of Business**

The association shall have its principal place of business in the city of \_\_\_\_\_, County of \_\_\_\_\_, State of \_\_\_\_\_.<sup>18</sup>

## **Article V—Period of Duration<sup>19</sup>**

The term for which this association shall exist is \_\_\_\_\_ years from and after the date of its incorporation.

## **Article VI—Directors**

The number of directors of the association shall be \_\_\_\_\_.<sup>20</sup> Of the first elected board of directors \_\_\_\_\_ shall be elected for 1 year; \_\_\_\_\_ for 2 years; and \_\_\_\_\_ for 3 years; and thereafter all directors shall be elected for 3 years. The names and addresses of those who are to serve as incorporating

<sup>17</sup> If it is desired that an association not transact business with nonmembers, this section would require revision. If the association does not desire to qualify under section 521 of the Internal Revenue Code of 1954, this section can be partially or wholly omitted, depending upon the requirements of the State statute.

<sup>18</sup> Some States require the inclusion of the name of a resident agent upon whom process may be served.

<sup>19</sup> If the act under which the association is organized permits of perpetual existence this article may read, "This association shall have perpetual existence."

<sup>20</sup> If the statute under which an association is to be incorporated will permit, it is preferable to state in the articles of incorporation only the minimum number of directors that the association will have, providing in the bylaws, which may be more easily amended, for the actual number. The provision of staggered terms may not be permitted by the laws of some States. If not, this article should provide that all directors shall be elected each year.



directors until the first annual meeting of the members or until their successors are elected and qualified are:

<i>Name</i>	<i>Address</i>
-----	-----
-----	-----
-----	-----
-----	-----

**Article VII—Membership**

This association shall not have any capital stock, but shall admit applicants to membership in the association upon such uniform conditions as may be prescribed by the board of directors of the association, or in its bylaws. This association shall be operated on a cooperative basis for the mutual benefit of its members as producers, and membership in the association shall be restricted to producers, who shall patronize the association. The voting rights of the members of the association shall be equal and no member shall have more than one vote.<sup>21</sup> The property rights and interests of each member in the association shall be unequal; and shall be determined and fixed in the proportion that the patronage of each member shall bear to the total patronage of all the members with the association, but in determining property rights and interests all amounts allocated to each patron or evidenced by certificates of any kind shall be excluded, and, upon dissolution, the equity interests of members and patrons shall be determined as provided in the bylaws. New members admitted to membership shall be entitled to share in the property of the association in accordance with the foregoing general rule.

If the association is formed with capital stock, it is suggested that the following Article be substituted for this Article:

**Article VII—Capital Stock**

SECTION 1. *Authorized amount; classes.* The capital stock of the association shall consist of ----- shares, divided into ----- shares of common stock of the par value of \$----- per share, and ----- shares of preferred stock of the par value of \$----- per share.

SECTION 2. *Common Stock.* The common stock of this association may be purchased, owned, or held only by producers (1) who reside in the territory served by this association, (2) who patronize the association in accordance with uniform terms and conditions prescribed by it, and (3) who have been approved by the board of directors. "Producer" shall mean and include persons (natural or corporate) actually engaged in the production of -----, or other agricultural products, including tenants of land used for the production of any such product, and lessors of such land who receive as rent therefor part of any such product of such land, and cooperative associations (corporate or otherwise) of such producers.

Each member shall hold only one (1) share of common stock and each eligible holder of common stock shall be entitled to only one vote in any meeting of the stockholders.<sup>a</sup> In the event the board of directors of the association shall find, following a hearing, that any of the common stock of this association has come into the hands of any person who is not eligible for membership, or that the holder thereof has ceased to be an eligible member, or that such holder has not, for a period of two (2) years, marketed through the association the products covered by a marketing agreement or agreements with it, or has not otherwise patronized the association, such holder shall have no rights or privileges on account of such stock, or vote or voice in the management or affairs of the association other than the right to participate in accordance with law in case of dissolution. The association shall have the right, at its option, (a) to purchase such stock at its book or par value, whichever is less, as

<sup>a</sup> If voting on any other basis is permitted by the State statute and the incorporators desire to provide for another basis, this sentence should be revised accordingly.

<sup>21</sup> If voting on any other basis is permitted by the State statute and the incorporators desire to provide for another basis, this sentence should be revised accordingly.

determined by the board of directors of the association; (b) to require the transfer of any such stock at such book or par value, to any person eligible to hold it; or (c) to require such holder of any such stock to convert it into shares of preferred stock of equal value.

In exercising its right to purchase or to require the transfer or conversion of common stock into preferred stock, if such holder fails to deliver the certificate evidencing the stock, the association may cancel such certificate on its books and issue a new certificate of common or preferred stock, as the case may be, to the party entitled thereto.

The common stock of this association may be transferred only with the consent of the board of directors of the association and on the books of the association, and then only to persons eligible to hold it; and no purported assignment or transfer of common stock shall pass to any person not eligible to hold it any rights or privileges on account of such stock, or vote or voice in the management of the affairs of the association. This association shall have a lien on all of its issued common stock for all indebtedness of the holders thereof to the association. There shall be no dividends paid on the common stock.<sup>b</sup>

**SECTION 3. Preferred Stock.** The preferred stock of this association may be issued to any person, association, co-partnership, corporation or other organization, in series. It shall carry no voting rights.<sup>c</sup> Non-cumulative dividends of not to exceed six percent (6%) per annum may be paid on preferred stock when, if, and as declared by the board of directors.

Preferred stock may be transferred only on the books of the association; and may be redeemed in whole or in part on a pro rata basis at par plus any dividends declared thereon and unpaid, at any time on thirty (30) days' notice by the association, provided said stock is redeemed in the same order as originally issued by years. On the failure to deliver the certificate or certificates evidencing any such stock the association may cancel the same on its books. Stock which has been redeemed may, in the discretion of the board of directors, be reissued or retired. All such preferred stock so redeemed shall be paid for in cash at the par value thereof, plus any dividend declared thereon and unpaid; and such stock shall not bear dividends after it has been called for redemption.

This association shall have a lien on all of its issued preferred stock for all indebtedness of the holders thereof to the association.<sup>d</sup>

At the discretion of the board of directors, all dividends or distributions of the association or any part thereof may be paid in certificates of preferred stock or credits on preferred stock or ad interim certificates representing fractional parts thereof, subject to conversion into full shares.

Notwithstanding any of the foregoing provisions, the board of directors shall have the power, from time to time and at any time, to pay off or retire or secure a release or satisfaction of any preferred stock certificates to compromise or settle a dispute between a holder thereof and the association, to settle an estate of a deceased or bankrupt stockholder, or to close out a stockholder's interest when he has moved from the territory.

Upon dissolution or distribution of the assets of the association, the holders of all preferred stock shall be entitled to receive the par value of their stock, plus any dividend declared thereon and unpaid, before any distribution is made on the common stock.

<sup>b</sup> A number of cooperatives are choosing to eliminate dividends on common stock since the investment is usually small and members would prefer to receive all returns on a patronage basis. Also, a nonexempt association is taxable on net margins equal to the maximum permissible dividends payable on stock, if the board is given the discretion to determine the dividend rate. *United Cooperatives, Inc.*, 4 T. C. 93. Provision may be made for dividends on common stock, however, if that is desired.

<sup>c</sup> In some States all classes of stock are entitled to vote. If necessary, this provision should be revised accordingly; but in such cases care should be taken to restrict the right to hold preferred stock to producers who patronize the association.

<sup>d</sup> Whether a lien should be provided on preferred stock may depend on the intended use of such stock in the operations of the association. Some cooperatives use such stock primarily as a means of raising capital by sale to investors who may or may not be patrons. If this is the intent, it may be undesirable to provide a lien since this may tend to restrict the salability and circulation of the stock in a free market. On the other hand, if the stock is issued primarily to patrons in payment of patronage refunds, it may be deemed advisable to provide for a lien to aid the association in collecting indebtedness from patrons.

In testimony whereof, we have hereunto set our hands this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

STATE OF \_\_\_\_\_,<sup>22</sup>  
County of \_\_\_\_\_ ss.

Before me, a notary public, within and for said county and State, on this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, personally appeared \_\_\_\_\_, known to me to be one of the identical persons who executed the within and foregoing instrument, and he acknowledged to me that he had executed the same as his free and voluntary act and deed for the uses and purposes therein set forth.

Witness my hand and official seal the day and year above set forth.

\_\_\_\_\_,  
Notary Public.

In and for the county of \_\_\_\_\_, State of \_\_\_\_\_  
My Commission expires \_\_\_\_\_.

## Bylaws<sup>23</sup>

of \_\_\_\_\_ Association

### Article I—Purposes and Powers

The purposes for which this association is formed and the powers which it may exercise are set forth in the articles of incorporation of the association.

### Article II—Membership

**SECTION 1. *Qualifications.*** Any person, firm, partnership, corporation, or association, including both landlords and tenants in share tenancies, who is a bona fide producer of agricultural products in the territory in which the association is engaged in business, and who agrees to be a patron of the association and who pays such membership fees and meets such other conditions as may be prescribed by the board of directors, may become a member of the association. This association shall issue a certificate of membership to each member which shall be in such form as may be prescribed by the board of directors but shall not be transferable.

**SECTION 2. *Suspension or termination.*** If, following a hearing, the board of directors shall find that a member has ceased to be an eligible member or has not, for a period of two (2) years, marketed through the association the products covered by a marketing agreement or agreements with the association or has not otherwise patronized the association or has moved out of the territory in which the association is operating, it may suspend his rights as a member or terminate his membership. Upon termination of membership in the association, all rights and interests of such member in the association shall cease and such member shall be entitled only to payment or credit for the equitable appraised value of his property rights and interests in the association, as conclusively determined by the board of directors.<sup>24</sup> In determining property rights and interests all amounts allocated to each member or evidenced by certificates of any kind shall be excluded, and any such amounts shall be accounted for to members in accordance with the terms and conditions applicable thereto. No action taken hereunder shall impair the obligations or liabilities of either party under any contract with the association, which may be terminated only as provided therein.

<sup>22</sup> The required number of incorporators should acknowledge, and the acknowledgment form should conform to the requirements of the State of incorporation.

<sup>23</sup> The bylaws should be carefully checked against the State statute and the articles of incorporation, and should be consistent with them.

<sup>24</sup> The State statute may prescribe the rights of a person whose membership is terminated, in which case this provision should be made consistent.



If the association is formed with capital stock, it is suggested that this Article might be made to read as follows:

## Article II—Membership

Each member of this association shall be the holder of one fully paid share of its common stock. The requirements for ownership of common stock are set forth in the articles of incorporation. Any corporate member may be represented by any individual duly authorized in writing filed with the association.

## Article III—Meetings of Members

SECTION 1. *Annual Meeting.* The annual meeting of the members of this association shall be held in the town of \_\_\_\_\_, State of \_\_\_\_\_, at \_\_\_\_\_ o'clock a. m., on the \_\_\_\_\_ day of \_\_\_\_\_ of each year, or on any date which the board of directors shall designate at least 30 days in advance of the date specified above.

SECTION 2. *Special Meetings.* Special meetings of the members of the association may be called at any time by order of the board of directors, and shall be called at any time upon written request of at least ten percent (10%) of the members, provided, however, that in no case shall the required number of signatures to such a request be less than fifteen (15). The request shall state the time, place, and object of the meeting.

SECTION 3. *Notice of Meetings.* Written or printed notice of every regular and special meeting of members shall be prepared and mailed to the last known post office address of each member not less than five (5) days before such meeting. Such notice shall state the object or objects thereof and the time and place of meeting. No business shall be transacted at special meetings other than that referred to in the call.

SECTION 4. *Voting.* Each member shall be entitled to only one vote.<sup>25</sup> Voting by proxy or cumulative voting shall not be permitted. Absent members may vote on specific questions other than the removal of directors by ballots transmitted to the secretary by mail, and such ballots shall be counted only in the meeting at the time in which such vote is taken, provided that all members have been notified in writing, pursuant to action by the board of directors, of the exact wording of the motion or resolution upon which such vote is taken, and a copy thereof is forwarded with and attached to the vote of the member voting.

SECTION 5. *Quorum.* Ten (10) members or ten percent (10%) of members, whichever is greater, shall constitute a quorum for the transaction of business at any meeting of the association except for the transaction of business concerning which a different quorum is specifically provided by law or by these bylaws; but in the event a quorum is not present, such meeting may be adjourned from time to time by those present until a quorum is obtained.

SECTION 6. *Order of Business.* The order of business at the annual meeting shall be:

1. Roll call.
2. Proof of due notice of meeting.
3. Reading and disposal of minutes.
4. Annual reports of officers and committees.
5. Unfinished business.
6. New business.
7. Election of directors.
8. Adjournment.

## Article IV—Directors and Officers

SECTION 1. *Number and Qualifications of Directors.* The association shall have a board of directors of \_\_\_\_\_ (\_\_\_\_\_) members. Each director shall be a member of this association in good standing.<sup>26</sup> No person shall be eligible for the office of director if he is in competition with or is affiliated with any enterprise that is in competition with the association and if a majority of the board of directors

<sup>25</sup> If voting on any other basis is permitted by the State statute and the incorporators desire to provide for another basis, this sentence should be revised accordingly.

<sup>26</sup> If permitted by statute provision may be made authorizing representatives of incorporated members to be directors.

of the association finds at any time following a hearing that any director is so engaged or affiliated he shall thereupon cease to be a director.<sup>27</sup>

SECTION 2. *Election of Directors.* At the first annual meeting of the members of this association directors shall be elected to succeed the incorporating directors. (-----) directors shall be elected for 1 year; (-----) directors for 2 years; and (-----) directors for 3 years.<sup>28</sup> At least two nominees shall be nominated for each directorship. All directors shall be elected by secret ballot and the nominee receiving the greatest number of votes shall be elected.

SECTION 3. *Election of Officers.* The board of directors shall meet within (-----) days after the first election and within (-----) days after each annual election and shall elect by ballot a president, vice president, secretary, and treasurer (or a secretary-treasurer), each of whom shall hold office until the election and qualification of his successor unless earlier removed by death, resignation, or for cause. The president and vice president only need be members of the board of directors. Vacancies in such offices shall be filled by the board of directors through election by ballot.

SECTION 4. *Vacancies.* Whenever a vacancy occurs in the board of directors, other than from the expiration of a term of office, the remaining directors shall appoint a member to fill the vacancy until the next regular meeting of the members.

SECTION 5. *Board Meetings.* In addition to the meetings mentioned above, regular meetings of the board of directors shall be held (monthly, quarterly, or semiannually) or at such other times and at such places as the board may determine.

SECTION 6. *Special Meetings.* A special meeting of the board of directors shall be held whenever called by the president or by a majority of the directors. Any and all business may be transacted at a special meeting. Each call for a special meeting shall be in writing, signed by the person or persons making the same, addressed and delivered to the secretary, and shall state the time and place of such meeting. On the signing of a waiver of notice of a meeting, a meeting of the board of directors may be held at any time.

SECTION 7. *Notice of Board Meetings.* Oral or written notice of each meeting of the board of directors shall be given each director by or under the supervision of the secretary of the association not less than 48 hours prior to the time of meeting, but such notice may be waived by all the directors, and appearance at a meeting shall constitute a waiver of notice thereof.

SECTION 8. *Compensation.* The compensation, if any, of the members of the board of directors and of the executive committee shall be determined by the members of the association at any annual or special meeting of the association. No member of the board of directors shall occupy any position in the association on regular salary.

SECTION 9. *Quorum.* A majority of the board of directors shall constitute a quorum at any meeting of the board.

## Article V—Duties of Directors

SECTION 1. *Management of Business.* The board of directors shall have general supervision and control of the business and the affairs of the association and shall make all rules and regulations not inconsistent with law or with these bylaws for the management of the business and the guidance of the members, officers, employees, and agents of the association. It shall have installed an accounting system which shall be adequate to the requirements of the business and it shall be its duty to require proper records to be kept of all business transactions.

SECTION 2. *Employment of Manager.* The board of directors shall have power to employ a manager, define his duties, fix his compensation, and to dismiss him with or without cause at any time. The board shall employ or authorize the employment of such employees, agents, and counsel as it from time to time deems necessary or advisable in the interest of the association, prescribe their duties, and fix their compensation. The manager shall have charge of the business of the association under the direction of the board of directors.

<sup>27</sup> It is sometimes deemed advisable to include a provision like the following: No director after having served for two consecutive terms shall be eligible to succeed himself, but after a lapse of one year shall again be eligible.

<sup>28</sup> The provision of staggered terms may not be permitted by the laws of some States. If not, this sentence should provide that all directors shall be elected each year.

**SECTION 3. Bonds and Insurance.** The board of directors shall require the manager and all other officers, agents, and employees charged by the association with responsibility for the custody of any of its funds or negotiable instruments to give adequate bonds. Such bonds, unless cash security is given, shall be furnished by a responsible bonding company and approved by the board of directors and the cost thereof shall be paid by the association. The board of directors shall provide for the adequate insurance of the property of the association, or property which may be in the possession of the association, or stored by it, and not otherwise adequately insured, and in addition adequate insurance covering liability for accidents to all employees and the public.

**SECTION 4. Audits.** At least once in each year the board of directors shall secure the services of a competent and disinterested public auditor or accountant, who shall make a careful audit of the books and accounts of the association and render a report in writing thereon, which report shall be submitted to the members of the association at their annual meeting. This report shall include at least (1) a balance sheet showing the true assets and liabilities of the association; (2) an operating statement for the fiscal period under review which shall show the cost of, and receipts from, sales and the gross margins or loss from each of the major commodities handled during the period; and a statement of all expenses for the period under review.

**SECTION 5. Agreements With Members.** The board of directors shall have the power to carry out all agreements of the association with its members in every way advantageous to the association representing the members collectively.

**SECTION 6. Depository.** The board of directors shall have power to select one or more banks to act as depositories of the funds of the association and to determine the manner of receiving, depositing, and disbursing the funds of the association and the form of checks and the person or persons by whom they shall be signed, with the power to change such banks and the person or persons signing such checks and the form thereof at will.

## Article VI—Duties of Officers

**SECTION 1. Duties of President.** The president shall (1) preside over all meetings of the association and of the board of directors, (2) call special meetings of the board of directors, (3) perform all acts and duties usually performed by an executive and presiding officer, and (4) sign all membership<sup>29</sup> certificates and such other papers of the association as he may be authorized or directed to sign by the board of directors: *Provided, however,* that the board of directors may authorize any person to sign any or all checks, contracts, and other instruments in writing on behalf of the association. The president shall perform such other duties as may be prescribed by the board of directors.

**SECTION 2. Duties of the Vice President.** In the absence or disability of the president, the vice president shall perform the duties of the president.

**SECTION 3. Duties of Secretary.** The secretary shall keep a complete record of all meetings of the association and of the board of directors and shall have general charge and supervision of the books and records of the association. He shall sign all membership<sup>29</sup> certificates with the president and such other papers pertaining to the association as he may be authorized or directed to sign by the board of directors. He shall serve all notices required by law and by these bylaws and shall make a full report of all matters and business pertaining to his office to the members at the annual meeting. He shall keep the corporate seal and all books of blank certificates, complete and countersign all certificates issued, and affix the corporate seal to all papers requiring a seal. He shall keep complete membership<sup>30</sup> records. He shall act as secretary of the executive committee. He shall make all reports required by law and shall perform such other duties as may be required of him by the association or the board of directors. Upon the election of his successor, the secretary shall turn over to him all books and other property belonging to the association that he may have in his possession.

**SECTION 4. Duties of Treasurer.** The treasurer shall perform such duties with respect to the finances of the association as may be prescribed by the board of directors.

<sup>29</sup> If the association is formed with capital stock, this word should be changed to "stock."

<sup>30</sup> If the association is formed with capital stock, this word should be changed to "stock ownership."



## **Article VII—Executive Committee and Other Committees**

SECTION 1. *Powers and Duties.* The board of directors may in its discretion appoint from its own membership an executive committee of three (3) members, determine their tenure of office and their powers and duties. The board of directors may allot to such executive committee all or any stated portion of the functions and powers of the board of directors, subject to the general direction, approval, and control of the board. Copies of the minutes of any meeting of the executive committee shall be mailed to all directors within seven (7) days following such meeting.

SECTION 2. *Other Committees.* The board of directors may, in its discretion, appoint such other committees as may be necessary.

## **Article VIII—Duties of Manager**

SECTION 1. *In General.* Under the direction of the board of directors the manager shall have general charge of the ordinary and usual business operations of the association, including the purchasing, marketing, and handling of all products and supplies handled by the association. He shall, so far as practicable, endeavor to conduct the business in such a manner that the members and patrons will receive just and fair treatment. The manager shall deposit all money belonging to the association which comes into his possession in the name of the association in a bank selected by the board of directors, and if authorized to do so by the board of directors shall make all disbursements by check therefrom for the ordinary and necessary expenses of the business in the manner and form prescribed by the board of directors. Upon the appointment of his successor, the manager shall deliver to him all money and property belonging to the association which he has in his possession or over which he has control.

SECTION 2. *Duty to Account.* The manager shall be required to maintain his records and accounts in such a manner that the true and correct condition of the business may be ascertained therefrom at any time. He shall render annual and periodical statements in the form and in the manner prescribed by the board of directors. He shall carefully preserve all books, documents, correspondence, and records of whatever kind pertaining to the business which may come into his possession.

SECTION 3. *Control of Employees.* Subject to the approval of the board of directors, the manager shall employ, supervise, and dismiss any or all employees of the association but not agents or counsel specifically employed by the board of directors.

## **Article IX—Membership Certificates**

The board of directors shall cause to be issued appropriate certificates of membership.

If the association is organized with capital stock, it is suggested that this article might be made to read as follows:

### **Article IX—Stock Certificates**

SECTION 1. *Common Stock.* Each certificate of common stock shall show on its face its designation by class and the privileges, voting rights or restrictions and qualifications applicable to shares of such class as specified in the articles of incorporation.

SECTION 2. *Preferred Stock.* Each certificate of preferred stock shall show on its face the preferences, privileges, voting rights or restrictions and qualifications of such stock as specified in the articles of incorporation.

## **Article X—Patrons and Patrons' Net Margins**

SECTION 1. *Patrons.* Each patronage transaction between this association and each patron shall be subject to and shall include as a part of its terms each provision of this Article X, whether it be expressly referred to in said transaction or not; and no person shall have any authority to transact any business for this association with any patron on any terms inconsistent with this Article X. Upon selling or consigning or otherwise delivering any agricultural product to this association or contracting to do so, and upon buying or otherwise receiving any farm supplies or

equipment from this association or contracting to do so, each patron, with or without then executing any writing or doing any other act, thereby:

(a) Shall, as further consideration due him from this association on account of such transaction, become entitled to have paid to him such proportion of the Patrons' Net Margins received by this association as his patronage bears to the aggregate patronage of all patrons, all as more particularly hereinafter defined and provided; and

(b) Shall, in consideration of similar agreements by others in the same fiscal year, promise and agree to invest in the capital of this association (revolving fund) as requested by the board of directors \_\_\_\_\_<sup>31</sup> of the agricultural products sold, consigned or otherwise delivered to the association, which amount is hereby made deductible from the sales proceeds otherwise payable to the patron, and, in addition, such further sum or sums of money as the board of directors may specify: *Provided, however*, That his obligation to invest in said capital in any fiscal year of this association in addition to the rate prescribed above shall be limited to an amount equal to his share of the Patrons' Net Margins for the fiscal year next preceding the fiscal year in which such investment is required of him and shall be proportionate to the investments required of other patrons; it being the intention and agreement of this association and each patron and of its several patrons with each other that as the board of directors shall deem the capital of this association to be inadequate, or deem additional capital to be necessary to repurchase or retire previously issued certificates of indebtedness or capital interests, then its several patrons shall, subject to the foregoing limitations, furnish such additional capital as may be required, and shall do so substantially in proportion to their respective patronage in the preceding fiscal year.

SECTION 2. *Computation of Patrons' Net Margins.* The Patrons' Net Margins, calculated upon the basis of each fiscal year, shall be computed as follows:

(a) *Gross Receipts.* All proceeds of all sales of products marketed for patrons, plus all sums received for supplies and equipment procured for patrons, plus all sums received from all other sources except loans or contributions to this association or investments in its capital, shall be deemed to be the "Gross Receipts."

(b) *Patrons' Net Margins.* This association shall deduct from such Gross Receipts the sum of the following items:

(1) all costs and expenses and other charges which are lawfully excludible or deductible from this association's Gross Receipts for the purpose of determining the amount of any net margin of this association; and

(2) an amount equal to \_\_\_\_\_ percent (\_\_\_\_%) of the balance of the Gross Receipts which remain after first having deducted therefrom the items referred to in clause (1) above.<sup>32</sup>

If in any fiscal year this association shall incur a net operating loss which is recognizable for tax purposes, the board of directors shall have full authority to charge off such loss either against net margins of future years or against revolving fund credits or in such other manner as will afford the association the maximum benefit for tax purposes.

The balance of said Gross Receipts which remain after the foregoing deductions shall be deemed to be the "Patrons' Net Margins."

The amount deducted pursuant to clause (2) above shall be set aside in a reserve and apportioned to patrons in accordance with their patronage during the fiscal year; *Provided, however*, that when such reserve shall reach the sum of \$\_\_\_\_\_ the board of directors in its discretion may either

(a) make no further deductions; or (b) retire such amounts of such reserve as it considers may be in excess of the association's reserve needs.<sup>33</sup> Such retirement

<sup>31</sup> Here insert either "\_\_\_\_\_ percent of the gross resale price" or "\_\_\_\_\_ cents per unit (i. e.—bushel, carton)."

<sup>32</sup> If the association is formed with capital stock, add the following paragraph: "and (3) an amount not exceeding six percent (6%) of the aggregate par value of all shares of preferred stock issued and outstanding at the close of said fiscal year." The provisions of this clause must be coordinated with whatever provision is made for the payment of dividends in the articles of incorporation. If provision is made for dividends on common stock, a provision should be included here authorizing their payment.

<sup>33</sup> Statutory requirements concerning reserves should be ascertained and met. It is quite possible that the flexibility suggested in the above provision would not be possible of adoption in many States.

shall be accomplished by paying off in full or pro rata patrons' apportioned interests, by years, the oldest being paid first.<sup>34</sup>

All of the Patrons' Net Margins shall, as received by the association, belong to and be held by the association for its respective patrons, and shall be distributed to them at the close of each fiscal year on a patronage basis. There shall be no discrimination between member and nonmember patrons in either the computation or payment of the Patrons' Net Margins; provided, that if a nonmember patron is eligible for membership, the amount of his share of the Patrons' Net Margins shall be credited to his individual account, and when such credit shall equal the amount of the required membership fee, a membership certificate shall be issued to him.<sup>35</sup>

The patrons' respective shares of the Patrons' Net Margins shall be computed upon the basis of their respective patronage of, and the net margins resulting from the operations of, the various pools or departments of this association and shall be in proportion to the quantity or value of the products delivered by, or supplies or equipment procured for, such patrons.<sup>36</sup>

**SECTION 3. *Payment of Patrons' Net Margins.*** Each patron's share of the Patrons' Net Margins shall be payable to him in cash at the close of each fiscal year, but the legal offset of the payments due a patron against the obligation of such patron to subscribe for capital, as provided in section 1(b) of this Article X, shall constitute full and complete discharge of the obligation of the association to make payment as herein provided.

**SECTION 4. *Lien.*** This association shall have a first lien on the interest of each patron in the Patrons' Net Margins for all indebtedness of such patron to this association.

## **Article XI—Revolving Fund**

**SECTION 1. *Purpose.*** This association shall establish and maintain a revolving fund for the purpose of acquiring and maintaining adequate capital to finance its business.

**SECTION 2. *Investment in Fund.*** This association may require investment in its revolving fund as provided in Article X, Section 1 (b) of these bylaws. Proper entries shall be made in the books and records of this association so that the net credit to each holder of an interest in the revolving fund in each year can be ascertained at any time. This association may issue revolving fund certificates to evidence credits in such fund, and the certificates may be in such form and contain such terms and conditions not inconsistent with this Article XI as the board of directors may prescribe.

**SECTION 3. *Operation.*** Investments in the revolving fund need not be segregated from, but on the contrary may be invested in or commingled with, any other assets of this association. No dividend, interest, or any other income shall be declared or paid on account of any net credits in the revolving fund. This association shall have a first lien on each revolving fund credit for all indebtedness of the holders thereof to this association.

**SECTION 4. *Repayment.*** If and when in the judgment of the board of directors the net balance in the revolving fund shall exceed the amount of capital reasonably needed by the association, it shall apply such excess to the retirement, in full or pro rata, of any or all the net credits in the revolving fund; provided, that such certificates shall be retired in the order of issuance by years and there shall be no discrimination between investments received in the same fiscal year. Notwithstanding any other provision of this section the board of directors, in its discretion, may retire any net credits at any time when the holder shall either (a) die, or (b)

<sup>34</sup> If the association is formed with capital stock, it is suggested that the following additional paragraph be inserted at this point: "The amounts deducted pursuant to clause (3) above may, in whole or in part, in the discretion of the board of directors, either be declared and paid as dividends on preferred stock or be transferred to any reserve or capital account of the association, or distributed to the patrons on a patronage basis."

<sup>35</sup> If the association is formed with capital stock, it is suggested that the following language be substituted following the words "individual account": "and when such credits shall equal the par value of a share of capital stock, one such share shall be issued to him. Such share shall be common stock if said patron is then eligible to hold common stock or preferred stock if such patron is then ineligible to hold common stock."

<sup>36</sup> If the type of operations will permit, an association may wish to make this provision more specific and elect either the dollar volume or physical unit volume as the basis of allocation between patrons.



otherwise cease to be a producer, or (c) remove from the territory served by the association.

SECTION 5. *Transfer.* No assignment or transfer of any revolving fund shall be binding on this association without the consent of the board of directors nor until it shall have been entered in the books of this association.

### **Article XII—Dissolution**

Upon the dissolution of this association, all debts and liabilities of this association shall first be paid according to their respective priorities. The holders of credits in the revolving fund shall then be paid the amount of their credits in said fund. Holders of membership in the association shall then be paid an amount equal to the membership fee which they paid in order to acquire membership in the association. Any remainder of such property shall be distributed among the patrons who patronized the association during the five (5) fiscal years immediately preceding dissolution on the basis of their respective patronage as shown by the records of this association.

If the association is formed with capital stock, it is suggested that this section be changed to read as follows:

### **Article XII—Dissolution**

Upon the dissolution of this association, all debts and liabilities of this association shall first be paid according to their respective priorities. Any property remaining after discharging the debts and liabilities of this association shall be distributed to the stockholders and patrons of this association. Holders of shares of preferred stock shall first be paid, and shall be limited to, the par value of their preferred shares, plus any dividends declared thereon and unpaid. Holders of shares of common stock shall next be paid, and shall be limited to, the par value of their common shares. Holders of credits in the revolving fund shall then be paid the amount of their credits in said fund. The remainder of such property shall be distributed among the patrons who patronized this association during the five (5) fiscal years immediately preceding dissolution on the basis of their respective patronage as shown by the records of this association.<sup>a</sup>

<sup>a</sup> Whether this or some other priority of payment should be prescribed will depend primarily (1) upon the requirements of applicable State law, and (2) the intended plan of operation. If the State law permits a choice, whether preferred stockholders should be paid prior to holders of revolving fund interests, or vice versa, would be influenced by whether the cooperative deems it advisable to favor one method over the other as a means of raising capital.

### **Article XIII—Unclaimed Money.**

A claim for money against the association shall be subject to the provisions of this section whenever the association is ready, able, and willing to pay such claim, and has paid or is paying generally claims arising under similar circumstances, but payment of such claim cannot be made for the reason that the association does not know the whereabouts or mail address of the one to whom it is payable or the one entitled to payment. If such claim be not actually paid within a period of ----- years<sup>37</sup> after it became payable as herein provided, the association shall remove the claim as a liability on its books; provided that no such removal shall be made unless at least 30 days prior thereto the association shall have sent by registered United States post, with the return receipt requested, a written notice of the proposed removal, addressed to the person appearing from the association's records to be entitled to payment of such money at the last address of such person shown by the records of the association. If any such claim be removed of record after giving such notice, the claim shall be deemed extinguished but the association shall continue to maintain a memorandum record of such claim and shall pay the principal amount thereof without interest to any claimant who subsequently establishes to the satisfaction of the association his right to receive payment. Any and all amounts recovered by the association pursuant to this Article, after deducting therefrom the

<sup>37</sup> Insert here a period equal to the applicable statute of limitations with respect to claims of this class.

amount of any taxes payable thereon, shall be placed in the reserve account of the association established under Article X, Section 2 (b) (2). Any claim paid after the expiration of the period of years herein specified shall be deducted from such account.

### Article XIV—Fiscal Year

The fiscal year of this association shall commence on the first day of \_\_\_\_\_ each year and shall end on the last day of \_\_\_\_\_ of the following year.

### Article XV—Miscellaneous Provisions

SECTION 1. *Bylaws Printed.* After adoption, these bylaws, preceded by the articles of incorporation, shall be printed in pamphlet form and a copy thereof shall be delivered to each member and to each person who later becomes a member of the association as shown on the books of record.

SECTION 2. *Seal.* The corporate seal of this association shall have inscribed on it the name of the association, \_\_\_\_\_, and the year of incorporation, \_\_\_\_\_.

### Article XVI—Amendments

If notice of the character of the amendment proposed has been given in the notice of meeting, these bylaws may be altered or amended at any regular or special meeting of the members by the affirmative vote of a majority of the members present or voting by mail.

We, the undersigned, being all of the incorporators and members of the \_\_\_\_\_ Association, do hereby assent to the foregoing bylaws and do adopt the same as the bylaws of said association; and in witness whereof, we have hereunto subscribed our names, this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

### Common Stock Certificate

Incorporated in \_\_\_\_\_  
No. \_\_\_\_\_ shares

\_\_\_\_\_  
(Name of association)

\_\_\_\_\_  
(Address)

Authorized capital \$ \_\_\_\_\_

Common stock \_\_\_\_\_ shares. Preferred stock \_\_\_\_\_ shares.  
Par value \$ \_\_\_\_\_ per share. Par value \$ \_\_\_\_\_ per share.

This certifies that \_\_\_\_\_ is the owner of \_\_\_\_\_ shares of common stock, each of a par value of \_\_\_\_\_ dollars (\$ \_\_\_\_\_) in the \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_.

(Name of association)

\_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, transferable on the books of the \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_.

(Town)

(State)

association on the surrender of this certificate, properly endorsed, by the holder thereof, or by an attorney properly authorized, which stock is subject to the following conditions:

(Here insert condensation of essential provisions of Article VII, sec. 2 of the Articles of Incorporation for a stock association)

Such common stock is subject to the preference given to preferred stock in the articles of incorporation of the association, and the holder hereof accepts the same subject to such preference, and it is also subject to all the other terms and conditions of the articles of incorporation and the bylaws now in effect or hereafter adopted.

In witness whereof the said association has caused this certificate to be signed by its duly authorized officers and its corporate seal to be hereunto affixed.

This \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

Attest:

\_\_\_\_\_  
President.

\_\_\_\_\_  
Secretary.

### Transfer of Common Stock

*(To be printed on back of stock certificates)*

For value received, and subject to the consent of the board of directors, the undersigned hereby sells, assigns, and transfers unto \_\_\_\_\_ shares of common stock represented by the within certificate, and does hereby irrevocably constitute and appoint \_\_\_\_\_ to transfer the said stock on the books of the within-named corporation with full power of substitution in the premises, this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

In the presence of \_\_\_\_\_

NOTICE.—The signature of this assignment must correspond with the name as written upon the face of the certificate in every particular without alteration or enlargement or any change whatever.

### Preferred Stock Certificate

Incorporated in \_\_\_\_\_  
No. \_\_\_\_\_ shares

\_\_\_\_\_  
(Name of association)

\_\_\_\_\_  
(Address)

Authorized capital \$\_\_\_\_\_

Common stock \_\_\_\_\_ shares.

Preferred stock \_\_\_\_\_ shares.

Par value \$\_\_\_\_\_ per share.

Par value \$\_\_\_\_\_ per share.

This certifies that \_\_\_\_\_ is the owner of \_\_\_\_\_ shares of preferred stock, each of a par value of \_\_\_\_\_ dollars (\$\_\_\_\_\_), in the \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, transferable on the books of the association on the surrender of this certificate, properly endorsed, by the holder thereof, or by attorney properly authorized, which stock is subject to the following conditions:

(Name of association)

(Town)

(State)

*(Here insert condensation of essential provisions of Article VII, sec. 3, of the Articles of Incorporation for a stock association)*

In witness whereof the said association has caused this certificate to be signed by its duly authorized officers and its corporate seal to be hereunto affixed.

This \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

Attest:

\_\_\_\_\_  
President.

\_\_\_\_\_  
Secretary.

### Transfer of Preferred Stock

*(To be printed on back of stock certificates)*

For value received, the undersigned this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, hereby sells, assigns, and transfers unto \_\_\_\_\_ shares of preferred stock represented by the within certificate, and does hereby



irrevocably constitute and appoint \_\_\_\_\_  
to transfer the said stock on the books of the within-named corporation with full  
power of substitution in the premises.

In the presence of: \_\_\_\_\_  
\_\_\_\_\_

NOTICE.—The signature to this assignment must correspond with the name as  
written upon the face of the certificate in every particular without alteration or  
enlargement, or any change whatever.

### Membership Certificate

This is to certify that \_\_\_\_\_ is a member of the  
\_\_\_\_\_ Association, and as such is entitled  
to the rights and privileges of membership and is likewise bound by and subject  
to the obligations and conditions pertaining thereto, all as set forth in the articles  
of incorporation, bylaws and marketing agreement, now or hereafter in effect.  
Said member has paid a membership fee of \$\_\_\_\_\_.

This certificate and the membership and rights represented hereby are  
nontransferable.

In witness whereof, the \_\_\_\_\_ Association has caused  
this certificate to be signed by its duly authorized officers and its corporate seal  
to be hereto affixed this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

By \_\_\_\_\_,

[SEAL]

*President.*

Attest:

By \_\_\_\_\_,  
*Secretary.*

### Revolving-Fund Certificate

Series 19 \_\_\_\_\_

No. \_\_\_\_\_ (Date) \_\_\_\_\_

Amount, \$ \_\_\_\_\_

This certifies that \_\_\_\_\_  
(Name)

of \_\_\_\_\_ has furnished  
\_\_\_\_\_ dollars to this association as capital,  
subject to the following conditions:

1. This and other revolving-fund certificates of the same series are retireable in  
the sole discretion of the board of directors, either fully or on a pro rata basis, but  
certificates issued in prior years shall be entitled to priority in retirement except in  
liquidation.

2. The amount stated in this certificate shall bear no interest.

3. This certificate is transferable only on the books of the association.

4. This and other certificates shall be junior and subordinate to all other debts  
of the association, both secured and unsecured. Upon the winding up or liquida-  
tion of the association in any manner, all revolving-fund certificates shall be retired  
in the order provided in the bylaws and shall be paid in full or on a pro rata basis,  
without priority.

In witness whereof the \_\_\_\_\_  
(Name of association)

has caused this certificate to be signed by its duly authorized officers and to be  
sealed with its seal, this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

\_\_\_\_\_  
\_\_\_\_\_

### Waiver of Notice of First Meeting of Members

We, the undersigned, being all the incorporators of \_\_\_\_\_  
\_\_\_\_\_ of \_\_\_\_\_

(Name of association)

(Town)

\_\_\_\_\_ constituting all the present members of such association,  
(State)

hereby waive notice of a meeting of the members and consent to the holding of a meeting of such members at \_\_\_\_\_ o'clock \_\_\_\_\_, on the \_\_\_\_\_ day of \_\_\_\_\_ (a. m. or p. m.) \_\_\_\_\_ 19\_\_\_\_, at \_\_\_\_\_ in \_\_\_\_\_ (Place of meeting) \_\_\_\_\_ (Town) \_\_\_\_\_ (State) for adopting bylaws for the government of the association and transacting any other business that may properly come before the meeting. Witness our signatures this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

### Waiver of Notice of First Meeting of Board of Directors

We, the undersigned, being all the directors of \_\_\_\_\_ (Name of association), \_\_\_\_\_ (Town), \_\_\_\_\_ (State) hereby waive notice of a meeting of the directors and consent to the holding of a meeting of such directors at \_\_\_\_\_ o'clock \_\_\_\_\_, on the \_\_\_\_\_ day of \_\_\_\_\_ (a. m. or p. m.) \_\_\_\_\_ (Day) \_\_\_\_\_ 19\_\_\_\_, at \_\_\_\_\_ in \_\_\_\_\_ (Place of meeting) \_\_\_\_\_ (Town) \_\_\_\_\_ for electing officers of the association to serve during the ensuing year, adopting the form of marketing agreement, and transacting any other business that may properly come before said meeting. Witness our signatures this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

### Minutes of First Meeting of Members

The first meeting of the members of \_\_\_\_\_ (Name of association) was held at \_\_\_\_\_ o'clock \_\_\_\_\_, on the \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, at \_\_\_\_\_ in \_\_\_\_\_ (a. m. or p. m.) \_\_\_\_\_ (Place of meeting) \_\_\_\_\_ (Town) \_\_\_\_\_ (State). The chair called for proof of notice of the meeting, whereupon \_\_\_\_\_ presented a waiver of notice and consent to hold the meeting signed by all the members of the association, which waiver and consent was in the following form:

*(Copy waiver of notice and consent to meeting.)*

The chair ruled that the meeting was properly called and it was ascertained that all the members of the association were present. The chair reported that the articles of incorporation of the association were filed on the \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, at \_\_\_\_\_ o'clock in the \_\_\_\_\_ noon, in the office of the Secretary of State of \_\_\_\_\_ and presented a copy of said articles of incorporation, which was read, and on motion duly made, seconded and carried, was directed to be entered in full in the minute book. (See page —.) A draft of proposed bylaws for the government of the association was presented by \_\_\_\_\_ and was read to the meeting and discussed section by section and as a whole, and the proposed bylaws were unanimously adopted. Each member affixed his signature to the bylaws and the secretary was instructed to spread the bylaws on the minutes of this meeting.

*(Here insert record of any other business that may have been transacted.)*

There being no further business to come before the meeting, on motion duly made, seconded and unanimously adopted, the meeting was adjourned.

\_\_\_\_\_  
Temporary Chairman.

\_\_\_\_\_  
Temporary Secretary.

## Minutes of First Meeting of Board of Directors

The first meeting of the board of directors of the \_\_\_\_\_, (Name of association)  
\_\_\_\_\_, was held at \_\_\_\_\_ o'clock \_\_\_\_\_, on \_\_\_\_\_  
(Town) (State) (a. m. or p. m.) (Day)  
\_\_\_\_\_, 19\_\_\_\_\_, at \_\_\_\_\_, in \_\_\_\_\_  
(Place of meeting) (Town)  
\_\_\_\_\_.  
(State)

Upon convening, \_\_\_\_\_ was elected temporary chairman and \_\_\_\_\_ temporary secretary of the meeting, and each assumed his office.

The Chair called for proof of notice of the meeting, whereupon \_\_\_\_\_ presented a waiver of notice and consent to hold the meeting, signed by all the directors of the association, which waiver and consent was in the following form:

*(Copy waiver of notice and consent to holding meeting.)*

Upon roll call of the directors of the association, the following answered present:

*(Record the names of all directors present.)*

The Chair ruled that proper and legal notice of the meeting had been given and that a quorum was present, and announced that the meeting was open for transacting business.

The Chair stated that the meeting was called for the purpose of electing officers<sup>38</sup> of the association for the ensuing year and transacting any other business that might properly come before the meeting.

Upon motion duly made and seconded, the following officers were unanimously elected to serve at the discretion of the board until the time of the first regular meeting of the board to be held as soon as practicable following the first annual meeting of the stockholders:<sup>39</sup>

*(Record the names of the officers elected and the title of the office.)*

Following the election of the officers, the president took the chair, and the secretary assumed his duties as secretary of the meeting.

Upon motion duly made, seconded, and carried, the following were appointed members of the executive committee, as provided in the bylaws:

*(Record the names.)*

Upon motion duly made and seconded, the following resolution was adopted:  
Resolved, that the Executive Committee be charged with the following specific powers and duties:

*(State here the specific powers and duties which it is desired to delegate during the period when the directors are not in session, subject to the general direction of the board.)*

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that the president and secretary be, and they are hereby, authorized to issue certificates of stock<sup>40</sup> in form as submitted to this meeting, and each in form as follows:

*(Here insert form of certificate of common stock and form of certificate of preferred stock, suggested forms of which appear in this Appendix)*

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that the president and secretary be, and they are hereby, authorized

<sup>38</sup> Omit if the officers are named in the articles of incorporation.

<sup>39</sup> Omit if the officers are named in the articles of incorporation.

<sup>40</sup> If the association is formed without capital stock the resolution should be changed to authorize the issuance of certificates of membership, a suggested form of which appears in this Appendix.



to have printed a sufficient number of copies of the articles of incorporation and bylaws, so that a copy thereof may be delivered to each member and each person who may later become a member of the association.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that the marketing agreement, in form as submitted to this meeting, a copy of which appears hereafter, is hereby approved:

*(Here insert form of marketing agreement)*

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that all subscriptions for stock <sup>41</sup> in the association and all marketing agreements tendered the association, appearing on the list submitted by the secretary, be accepted, and that the president and the secretary be, and they hereby are directed to carry out the terms and conditions of such stock subscriptions <sup>42</sup> and to execute all marketing agreements for and on behalf of the association.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that the \_\_\_\_\_ Bank be selected as a depository for the funds of the association.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that all checks drawn upon the \_\_\_\_\_ Bank, for withdrawal of funds of the association on deposit therewith, be signed by the manager (treasurer).

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that the manager (treasurer) is hereby authorized to receive all funds paid to the association, endorse all checks and other media of exchange, and deposit the same to the account of the association in \_\_\_\_\_ Bank.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that the executive committee be, and they are hereby, authorized to determine the amount of the bond or bonds which the bylaws specify shall be required of all officers, agents, and employees charged by the association with responsibility for the custody of any of its funds or property, and to see that the bonds, as required, are executed and presented for the approval of the board of directors.

*(Similar resolutions should be adopted, providing for the insurance of the property of the association and for adequate insurance covering other contingencies. Any additional business transacted by the board should also be recorded here.)*

There being no further business to come before the meeting, on motion duly made, seconded, and unanimously adopted, the meeting adjourned.

\_\_\_\_\_,  
Chairman.

<sup>41</sup> Substitute application for membership in the case of a nonstock association.

<sup>42</sup> Substitute "membership applications" in the case of a nonstock association.

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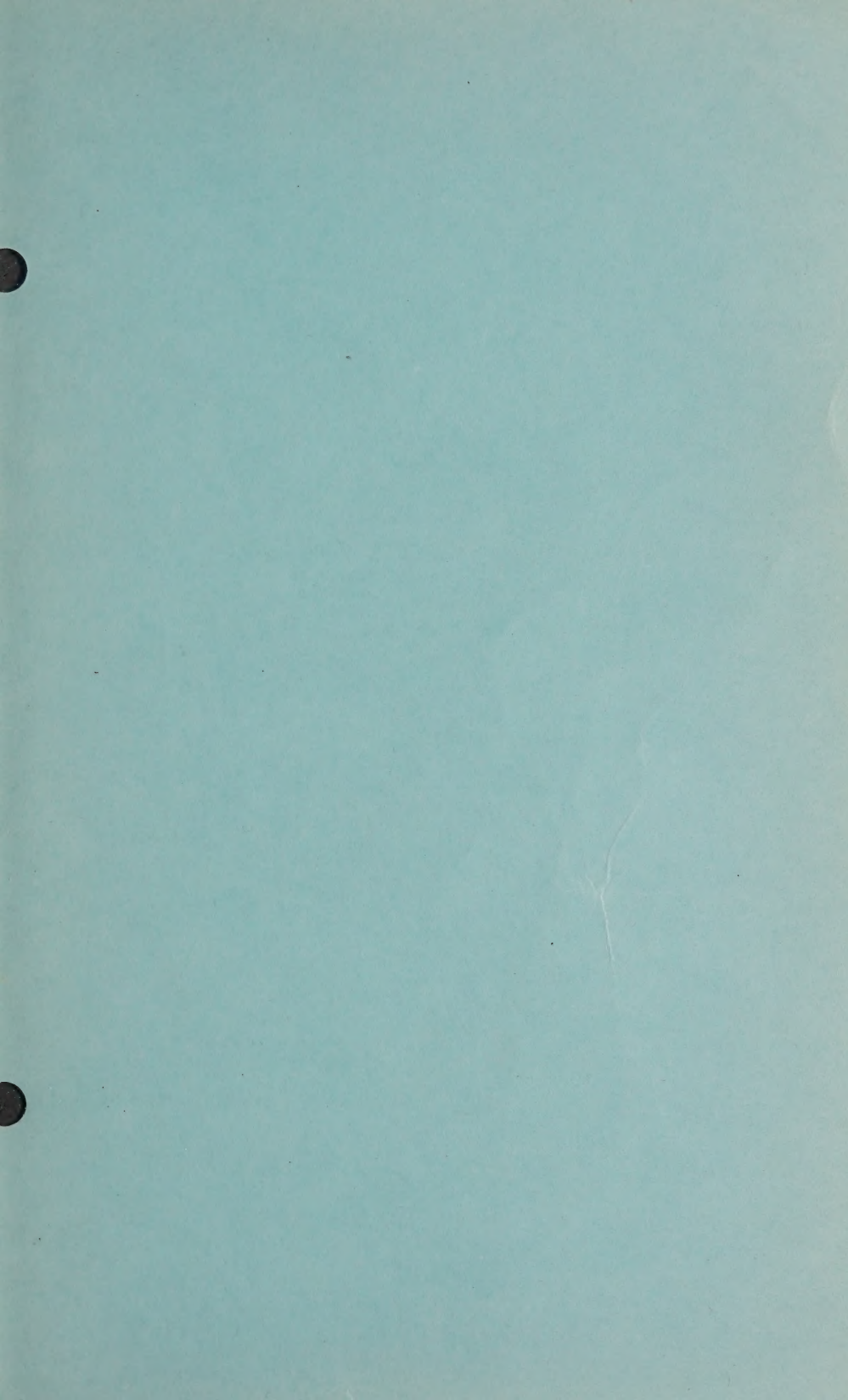
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